

DOCUMENT RESUME

ED 102 908

HE 006 275

TITLE Hearings Before the Subcommittee on Education of the Committee on Labor and Public Welfare, United States Senate, Ninety-Third Congress, Second Session on Examination of the Quaranteed Student Loan Program and the Incidence of Defaults and Interest Rates on Loans Under this Program.

INSTITUTION Congress of the U.S., Washington, D.C. Senate Committee on Labor and Public Welfare.

PUB DATE 74

NOTE 173p.

EDRS PRICE MF-\$0.76 HC-\$8.24 PLUS POSTAGE

DESCRIPTORS *Educational Finance; *Federal Legislation; Federal Programs; Financial Needs; *Financial Policy; Financial Support; *Higher Education; Student Costs; *Student Loan Programs; Student Needs

IDENTIFIERS *Guaranteed Student Loan Program

ABSTRACT

The hearings were conducted on September 18 and 19, 1974. This document contains statements by representatives, senators, the U.S. Commissioner of Education, and various directors and assistant directors of financial aid from U.S. colleges. Additional information included is as follows: articles, publications, and communications. Questions and answers from the committee to the witness are also included. (PG)

ED102908

EXAMINATION OF THE GUARANTEED STUDENT LOAN PROGRAM, 1974

SCOPE OF INTEREST NOTICE

The ERIC Facility has assigned
this document for processing
to:

HE

CG

In our judgment, this document
is also of interest to the clearing-
houses noted to the right. Index-
ing should reflect their special
points of view.

HEARINGS BEFORE THE SUBCOMMITTEE ON EDUCATION OF THE COMMITTEE ON LABOR AND PUBLIC WELFARE UNITED STATES SENATE NINETY-THIRD CONGRESS SECOND SESSION ON EXAMINATION OF THE GUARANTEED STUDENT LOAN PRO- GRAM AND THE INCIDENCE OF DEFAULTS AND INTEREST RATES ON LOANS UNDER THIS PROGRAM

SEPTEMBER 18 AND 19, 1974

U.S. DEPARTMENT OF HEALTH,
EDUCATION & WELFARE
NATIONAL INSTITUTE OF
EDUCATION

THIS DOCUMENT HAS BEEN REPRO-
DUCED EXACTLY AS RECEIVED FROM
THE PERSON OR ORGANIZATION ORIGIN-
ATING IT. POINTS OF VIEW OR OPINIONS
STATED DO NOT NECESSARILY REPRESENT
OFFICIAL NATIONAL INSTITUTE OF
EDUCATION POSITION OR POLICY.



Printed for the use of the Committee on Labor and Public Welfare

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1974

41-006 O

HE 006 275

COMMITTEE ON LABOR AND PUBLIC WELFARE

HARRISON A. WILLIAMS, Jr., New Jersey, *Chairman*

JENNINGS RANDOLPH, West Virginia
CLAIBORNE PELL, Rhode Island
EDWARD M. KENNEDY, Massachusetts
GAYLORD NELSON, Wisconsin
WALTER F. MONDALE, Minnesota
THOMAS F. EAGLETON, Missouri
ALAN CRANSTON, California
HAROLD E. HUGHES, Iowa
WILLIAM D. HATHAWAY, Maine

JACOB K. JAVITS, New York
PETER H. DOMINICK, Colorado
RICHARD S. SCHWEIKER, Pennsylvania
ROBERT TAFT, Jr., Ohio
J. GLENN BEALL, Jr., Maryland
ROBERT T. STAFFORD, Vermont

JOSEPH P. McMURRAY, *Staff Director and Chief Legislative Counsel*

MARJORIE M. WHITTAKER, *Chief Clerk*

ROY H. MILLENSON, *Minority Staff Director*

JAY B. CUTLER, *Minority Counsel*

SUBCOMMITTEE ON EDUCATION

CLAIBORNE PELL, Rhode Island, *Chairman*

JENNINGS RANDOLPH, West Virginia
HARRISON A. WILLIAMS, Jr., New Jersey
EDWARD M. KENNEDY, Massachusetts
WALTER F. MONDALE, Minnesota
THOMAS F. EAGLETON, Missouri
ALAN CRANSTON, California
WILLIAM D. HATHAWAY, Maine

PETER H. DOMINICK, Colorado
JACOB K. JAVITS, New York
RICHARD S. SCHWEIKER, Pennsylvania
J. GLENN BEALL, Jr., Maryland
ROBERT T. STAFFORD, Vermont

STEPHEN J. WEXLER, *Counsel*

RICHARD D. SMITH, *Associate Counsel*

ROY H. MILLENSON, *Minority Professional Staff Member*

(11)

CONTENTS

Text of:	Page.
S. 3807.....	74

CHRONOLOGICAL LIST OF WITNESSES

WEDNESDAY, SEPTEMBER 18, 1974

Bell, Terrell H., U.S. Commissioner of Education, Department of Health, Education, and Welfare, accompanied by Edward York, Deputy Commissioner for Management; Kenneth Kohl, Associate Commissioner, Office of Guaranteed Student Loans; David Bayer, Acting Director, Division of Program Development, Office of Guaranteed Student Loans; and Charles M. Cooke, Jr., Deputy Assistant Secretary for Legislation (Education).....	2
Fox, Edward, president; Timothy Greene, vice president and general counsel; and William Simmons, vice president for marketing, a panel representing the Student Loan Marketing Association.....	45
Mirandon, J. Wilmer, president, State Higher Education Assistance Corporation of New York.....	53

THURSDAY, SEPTEMBER 19, 1974

Tunney, Hon. John V., a U.S. Senator from the State of California.....	81
Clark, Dr. Robert B., director of financial aid at Oklahoma State University and president-elect of the National Association of Student Financial Aid Administrators, accompanied by Richard L. Tombaugh, executive secretary, National Association of Student Financial Aid Administrators.....	93
Evans, Jay W., president, National Council of Higher Education Loan Programs, accompanied by Carol Wennerdahl of Illinois; Bill Nester of New Jersey; and Ron Iverson, executive director, State of Vermont Student Assistance Corporation.....	123

STATEMENTS

Bell, Hon. Alphonzo, a Representative in Congress from the State of California, prepared statement.....	88
Bell, Terrell H., U.S. Commissioner of Education, Department of Health, Education, and Welfare, accompanied by Edward York, Deputy Commissioner for Management; Kenneth Kohl, Associate Commissioner, Office of Guaranteed Student Loans; David Bayer, Acting Director, Division of Program Development, Office of Guaranteed Student Loans, and Charles M. Cooke, Jr., Deputy Assistant Secretary for Legislation (Education).....	2
Prepared statement.....	27
Clark, Dr. Robert B., director of financial aid at Oklahoma State University and president-elect of the National Association of Student Financial Aid Administrators, accompanied by Richard L. Tombaugh, executive secretary, National Association of Student Financial Aid Administrators.....	93
Prepared statement.....	102
Evans, Jay W., president, National Council of Higher Education Loan Programs, accompanied by Carol Wennerdahl of Illinois; Bill Nester of New Jersey; and Ron Iverson, executive director, State of Vermont Student Assistance Corporation.....	123
Prepared statement.....	135
Fox, Edward, president; Timothy Greene, vice president and general counsel; and William Simmons, vice president for marketing, a panel representing the Student Loan Marketing Association.....	45
Mirandon, J. Wilmer, president, State Higher Education Assistance Corporation of New York.....	53
Prepared statement.....	57

(III)

National Association of Student Financial Aid Administrators, prepared statement.....	Page 102
National Council of Higher Education Loan Programs, prepared statement.....	135
New York Higher Education Assistance Corp., prepared statement.....	87
Percy, Hon. Charles H., a U.S. Senator from the State of Illinois, prepared statement.....	86
Pettis, Hon. Jerry L., a Representative in Congress from the State of California, prepared statement.....	90
Tunney, Hon. John V., a U.S. Senator from the State of California.....	81
Prepared statement.....	83

ADDITIONAL INFORMATION

Articles, publications, etc.:

Analysis by Office of Education of the Default Table, prepared by the General Accounting Office.....	9
"Bank Out of Student-Loan Program," by Julie Emery, from the Seattle Times, July 22, 1974.....	120
"Categories of Institutions Ineligible for State Loans".....	133
"Claims and Collection" report.....	131
"College Students Default on \$252 Million Government Loan," by Bernie Ward.....	146
"Defaults Threaten Student Loans," by Jim Swarts, from the Kansas City Star.....	149
"Personnel Involved in Guarantee Loan Program to States".....	133
"Questionable Loans and Default Rates".....	54
"Statement of Organization, Functions, and Delegations of Authority, Office of Education," from the Federal Register, vol. 39, No. 138, July 17, 1974.....	24
"Student Loans, Outlook Still Dismal," by Nancy Lewis, from the Atlanta Journal and Constitution, September 8, 1974.....	114
"Summary Document on the Guaranteed Student Loan Program," prepared by the General Accounting Office staff from Office of Education records model.....	4

Communications to:

Cranston, Hon. Alan, a U.S. Senator from the State of California, from Kenneth C. Adams, vice president and general counsel, U.S. Life Savings and Loan Association, Los Angeles, Calif., September 18, 1974 (with enclosures).....	181
Moore, Mrs. Vivian, administrative assistant, Office of Senator Symington, from Jack V. Hoskins, attorney and counselor at law, St. Louis, Mo., September 19, 1974.....	183
Pell, Hon. Claiborne, a U.S. Senator from the State of Rhode Island, from:	
Archer, Melville W., Emporia, Kans., November 18, 1974 (with enclosure).....	147
Alford, Albert L., Assistant Commissioner for Legislation, Department of Health, Education, and Welfare, Washington, D.C., October 31, 1974 (with enclosures).....	13
Clark, Robert B., president-elect, National Association of Student Financial Aid Administrators, Washington, D.C., September 23, 1974.....	99
Cunningham, P. Jerome, past president, Connecticut Association of Student Financial Aid Administrators, September 10, 1974.....	145
Kohl, K. A., Associate Commissioner, Office of Guaranteed Student Loans, Department of Health, Education, and Welfare, Washington, D.C., November 29, 1974 (with enclosures).....	41
Lowrie, Gerald M., the American Bankers Association, Government relations, Washington, D.C., October 3, 1974.....	144
McCabe, Edward A., chairman, Student Loan Marketing Association, Washington, D.C., November 21, 1974 (with attachment).....	49
Mirandon, J. Wilmer, president, New York Higher Education Assistance Corporation, Albany, N.Y., November 20, 1974 (with enclosures).....	63

Communications to—Continued

Tombaugh, Richard L., executive secretary, National Association of Student Financial Aid Administrators, from:	
Baldree, H. Allen, assistant director, Student Financial Aid, Armstrong State College, Savannah, Ga., July 24, 1974.....	118
Bosone, Frank P., director of financial aid, Bellevue Community College, Bellevue, Wash., July 24, 1974 (with enclosure).....	119
Chalmers, Joseph A., Ph. D., dean of admissions and records, Georgetown University, Washington, D.C., July 31, 1974.....	117
Dolan, Michael J., director of financial aid, Seattle University, Office of Financial Aid, Seattle, Wash., July 30, 1974 (with enclosure).....	121
Finch, Mrs. Lola, associate dean of students, Washington State University, Pullman, Wash., July 24, 1974.....	118
Gray, Thomas J., president, Midwest Business College, Inc., Colorado Springs, Colo., July 24, 1974.....	119
Miller, John H., General Educational Services Corp., Los Angeles, Calif., August 1, 1974.....	115
Novak, Michael A., director, University of Missouri—Kansas City, Student Financial Aid Office, Kansas City, Mo., July 31, 1974.....	116
Twichell, Charles L., director of student aid, Dickinson College, Carlisle, Pa., September 2, 1974.....	115
Walker, W. J., director, Student Financial Aid, the University of Alabama in Birmingham, Birmingham, Ala., July 31, 1974.....	116
Wood, William P., director of financial aid, Edison, Community College, Fort Myers, Fla., July 25, 1974.....	119
Wexler, Stephen J., counsel, Subcommittee on Education, from William C. Nester, director, New Jersey Higher Education Assistance Authority, Trenton, N.J., December 12, 1974 (with enclosures).....	160
Questions and answers:	
Responses by Office of Education to questions raised by Senator Pell..	15

EXAMINATION OF THE GUARANTEED STUDENT LOAN PROGRAM, 1974

WEDNESDAY, SEPTEMBER 18, 1974

U.S. SENATE,
SUBCOMMITTEE ON EDUCATION OF THE
COMMITTEE ON LABOR AND PUBLIC WELFARE,
Washington, D.C.

The subcommittee met pursuant to notice, at 11:40 a.m., in room 1318, Dirksen Senate Office Building, Hon. Claiborne Pell [subcommittee chairman] presiding.

Present: Senator Pell.

Committee staff present: Stephen J. Wexler, counsel; and Roy H. Millenson, minority professional staff.

Senator PELL. The hearing of the Subcommittee on Education will come to order.

I apologize for the delay, but it was unavoidable because there was voting on the floor of the Senate.

Today we will be discussing the Guaranteed Student Loan Program and, more specifically, the incidence of defaults on loans under this program.

The Guaranteed Student Loan Program was enacted in 1965 as a supplemental program of loans of convenience for middle-income students. This point should be clearly understood, for it was the original intent of the Congress that the three major forms of Federal student assistance, then available, the National Defense Student Loans (NDSL), Basic Educational Opportunity Grants (BEOG), and Work/Study Programs, would be of primary importance and the then-new loan program be a supplemental standby mechanism.

Over the years, due to niggardly funding of the three programs, the Guaranteed Student Loan Program was utilized to meet more and more of the main responsibility for Federal student assistance.

Even with the enactment of the 1972 amendments, which created a major new Federal program of student assistance, the BEOG, for which about \$650 million is to be appropriated for next year, the inflationary spiral which we have been experiencing along with a still inadequate level of funding of the other three primary student-aid programs, has put even greater pressure on the Guaranteed Student Loan Program.

In the 1972 amendments, the Congress created what we thought to be a simple secondary market mechanism. However, this new organization, the Student Loan Marketing Association (SLMA), known by the acronym SALLIE MAE, was initiated in a period of high money cost. It has had trouble selling its own shares and has not yet achieved its objective of making available more funds for student loans.

(1)

Indeed, at the present time, there is a question concerning the scope of the SLMA vis-a-vis the Office of Education with regard to lending funds to institutions.

I understand there are meetings being held between the Office of Education and SALLIE MAE concerning the interpretation of the law.

More important is the general question about the future of the Guaranteed Student Loan Program. It should be understood that, if we allow the Guaranteed Student Loan Program to grow, it will be one of the major Federal sources of funds for student assistance, since it is an open-ended program rather than grants.

There should be a conscious choice made with regard to this program, rather than an inexorable growth which will suddenly confront us with an accomplished fact, on which no real decision will have been made.

Today's hearing, which will discuss the default rate, will help prepare us to make a reasonable decision concerning the Guaranteed Student Loan Program.

Our first witness will be from the administration.

We have had an opportunity to go through the testimony, and it would be much appreciated if the testimony could be inserted in the record in full, summarized by you, and then get into some questions.

Our leadoff witness is Commissioner of Education Terrell Bell. He will introduce the other witnesses with him.

STATEMENT OF TERRELL H. BELL, U.S. COMMISSIONER OF EDUCATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, ACCOMPANIED BY EDWARD YORK, DEPUTY COMMISSIONER FOR MANAGEMENT; KENNETH KOHL, ASSOCIATE COMMISSIONER, OFFICE OF GUARANTEED STUDENT LOANS; DAVID BAYER, ACTING DIRECTOR, DIVISION OF PROGRAM DEVELOPMENT, OFFICE OF GUARANTEED STUDENT LOANS; AND CHARLES M. COOKE, JR., DEPUTY ASSISTANT SECRETARY FOR LEGISLATION (EDUCATION)

Mr. BELL. I have with me, Mr. Chairman, members of my staff.

I might comment that, as you likely know, in March, prior to my arriving on the scene as Commissioner, the administration of this program was shifted to the Deputy Commissioner for Management. I am pleased to have Mr. Edward York, Deputy Commissioner for Management, and also with him Mr. Kenneth Kohl, who comes to us from the position of director of undergraduate student financial aid at Princeton University. Mr. Kohl has just recently joined our staff as Associate Commissioner, Office of Guaranteed Student Loans.

Also with me, of course, are Charles Cooke, Deputy Assistant Secretary for Legislation, and David Bayer, Acting Director, Division of Program Development, Office of Guaranteed Student Loans.

If I may, I will just summarize the points that we made on defaults. And then, if it is all right with the chairman, we can proceed right to the questions and answers.

I will summarize from the testimony briefly.

Senator PELL. Your entire statement will be entered in the record at the conclusion of your testimony.

Mr. BELL. In order to progress toward a solution, we must first realize the scope of the problem.

The default problem, with its attendant claims and collections activities, provides an example of the overwhelming need for an improved management effort. Few things, if any, have affected the public image of the program as has the default problem, which is growing rapidly, as is demonstrated in figure 3 of the written testimony that I will not go into.

A default legally occurs when a student borrower fails to make a scheduled loan payment for a period of 120 days and the lender, after attempting to effect collection, certifies the loan as uncollectable under its terms and conditions.

The student borrower must have been out of school for not less than 9 nor more than 12 months before the first payment is due.

The efforts of the lender to establish contact with the borrower and to effect collection are covered under the legislated and regulatory areas of "due diligence."

In the case of federally insured loans, the lender then presents a claim to the Government. For loans insured by State or private guarantee agencies, the lender submits the claim to the appropriate agency. If the investigation of the claim finds the claim legally sufficient, the claim is paid.

The rate at which claims are paid—that is, the ratio of defaults to loans that have matured to repayment status—has been the subject of controversy. Analysis performed by the program staff over the last several months using the loan estimating model indicate the complexity of the problem.

First, a distinction must be made between a claim and a loss of the proceeds of a loan.

When a federally insured claim is paid, the Government has essentially purchased the loan; that is, the loan is not simply written off. It moves from the collection process of the original lender to that of the Federal Government.

Action of the Federal Government can, and does, cause loans for which claims were paid to revert to repayment status. Thus, the ultimate liability of the Federal Government is based not simply upon the payment of a claim, but also upon the Government's ability to reactivate loans.

Therefore, program losses are represented not by the rate at which lenders are currently submitting claims, but rather at the rate of true loss—the loss rate after the Government has made its effort to collect the debt and failed. The word "after" is emphasized since, as will be seen, this rate is decreased by our collection activity.

As the chairman knows, we are in the process of intensifying this activity.

Table 1 indicates a projected growth in the claims rate for the Federal program from a current rate of 14.5- to an 18.5-percent figure in fiscal year 1975.

I might say, parenthetically, that the loan projection model sees this going up to over 24 percent.

However, the projected loss rate will level off at about 12 percent for both years. This estimate is due to a forecasted substantial upgrading of our collection effort.

Senator PELL. Excuse me. What is your estimate of losses—
Mr. BELL. We estimate the claims rate will be 18.5 in fiscal year 1975.

Senator PELL. Percent?

Mr. BELL. Yes, sir.

Now, the loan projection model shows this going up to 24.3 percent.

We think, Mr. Chairman, that our intervention efforts on this would reduce this substantially.

Senator PELL. In other words, you have an as overall average proposed rate of default on these loans of 18.5 percent?

Mr. BELL. That is right.

Senator PELL. That is high; is it not?

Mr. BELL. It is high.

We believe that as we increase our efforts at collections, and as we do more with the added staff that we have, that possibly this will come down considerably.

Senator PELL. Excuse me. At this point I think we should insert in the record a summary that the GAO prepared, and I will ask the counsel to give you, concerning the default rates by types of schools, which is even more startling and even more compelling in its evidence showing, for instance, with proprietary schools that the expected rate of default, is 47.5 percent, almost 50 percent.

[The document referred to follows:]

SUMMARY DOCUMENT ON THE GUARANTEED STUDENT LOAN PROGRAM—PREPARED BY THE GENERAL ACCOUNTING OFFICE STAFF FROM OFFICE OF EDUCATION RECORDS MODEL

EXHIBIT I

GUARANTEED STUDENT LOAN FUND DEFAULT ESTIMATION MODEL

Development

In order to prepare more accurate budget submissions, OE's Office of Planning, Budgeting, and Evaluation engaged a contractor to develop a model that could be used to estimate the Federal Government's contingent liabilities and cash flow requirements for the Guaranteed Student Loan program. The model relies on data in an automated system (Guaranteed Student Loan System—GSLS II) controlled by the Office of Guaranteed Student Loans. The model was designed to estimate cash requirements for: (1) claim payments, (2) interest benefits, and (3) special allowances.

The first step in the development of the model consisted of identifying the variables that have the strongest relationship to defaults. The characteristics identified as the most important were:

- (A) School ownership
 - 1. Public
 - 2. Private (non-profit)
 - 3. Proprietary
- (B) Type of school
 - 1. College or university
 - 2. Junior college or institution
 - 3. Specialized or vocational
- (C) Accrediting agency of specialized or vocational schools

The contractor developed a model which uses the information in the GSLS II data files to simulate the loan process from commitment and disbursement through eventual repayment or default.

This model uses trends established to date to project total defaults when all loans are repaid. This method requires a thorough analysis of loans, repayments and defaults, with extensive use of estimates. The default rates computed by OE's model are substantially higher than default rates computed using previous methods; however, these higher rates represent an improvement in OE's estimating ability, not an increase in the default rate. Improvements in the completeness and accuracy of available data should increase the accuracy of the model estimates. Further improvements may also be obtained as OE evaluates and adjusts the model to more accurately reflect actual conditions.

Limitations

Although the model provides the best estimates of future defaults currently available, it has serious limitations which must be considered when evaluating the estimates:

- (1) It is based on the critical assumption that future borrower behavior on loan payments and defaults, and lender behavior on filing claims will follow patterns established to date (1968-1973).
A change in any of the following areas could effect future defaults and reduce the accuracy of default estimates produced by the model:
 - (A) Program management—for example, more aggressive collection action by OE could deter students from defaulting.
 - (B) Lender diligence—for example, more aggressive collection efforts by lenders could reduce defaults.
 - (C) Borrower behavior—for example, a change in borrower attitude could reduce defaults.
 - (D) Economic conditions—for example, increased unemployment could increase defaults.
 - (E) Legislation—for example, exemption of student loans from the bankruptcy statutes could reduce defaults.
- (2) The model is based on GSLS II data files which are not complete or accurate.
- (3) Current estimates are based on the GSLS II data files as they existed on December 31, 1973, omitting data on almost 9 months of program experience.
- (4) The accuracy and reliability of the model have not been demonstrated.
- (5) Trends showing increases or decreases in the default rate can only be obtained by comparing the results produced from subsequent usage of the model over a period of time.
- (6) The model produces voluminous amounts of data and extensive analysis is required to determine the full meaning of the output.
- (7) The model assumes the existence of certain conditions which may or may not exist. For example, it assumes that by the time the first payment is due on 60 percent of the loans in any category, 90 percent of the total defaults for that category will have occurred.

EXHIBIT II

EVENTUAL DEFAULT RATES, BY TYPE OF SCHOOL

	Loan amount (thousands)	Eventual default rate	Eventual default amount (thousands)
I. Public:			
College and universities.....	\$868,960	11.9	\$102,719
Junior college and institutions.....	118,236	36.0	42,614
Specialized and vocational.....	40,877	24.3	9,941
Other (unidentified).....	61,405	18.9	11,611
Total.....	1,089,472	15.4	167,885
II. Private (nonprofit):			
Colleges and universities.....	357,349	11.2	39,977
Junior colleges and institutions.....	20,853	19.6	4,077
Specialized and vocational.....	5,565	31.8	1,749
Total.....	383,707	11.9	45,803
III. Proprietary:			
Colleges and universities.....	8,992	43.2	3,887
Junior colleges and institutions.....	7,875	16.0	1,261
Specialized and vocational.....	602,033	48.1	289,492
Total.....	618,900	47.6	294,640
Grand total.....	2,092,079	24.3	508,328
IV. Combined:			
Colleges and universities.....	1,235,301	11.9	147,583
Junior colleges and institutions.....	146,958	32.6	47,952
Specialized and vocational.....	648,415	46.6	301,182
Unknown.....	61,405	18.9	11,611
Total.....	2,092,079	24.3	508,328

COMPARISON OF LOAN AND DEFAULT VOLUME, BY TYPE OF SCHOOL

	Loan amount (thousands)	Percent of total loan volume	Eventual default amount (thousands)	Percent of default volume
I. Public:				
Colleges and universities.....	\$868,960	41.5	\$103,719	20.4
Junior colleges and institutions.....	118,230	5.6	42,614	8.4
Specialized and vocational.....	40,877	2.0	9,941	2.0
Other (unidentified).....	61,405	3.0	11,611	2.2
Total.....	1,089,472	52.1	167,885	33.0
II. Private (nonprofit):				
Colleges and universities.....	357,349	17.0	39,977	7.9
Junior colleges and institutions.....	20,853	1.0	4,077	.8
Specialized and vocational.....	5,905	.3	1,749	.3
Total.....	383,707	18.3	45,803	9.0
III. Proprietary:				
Colleges and universities.....	8,992	.4	3,887	.8
Junior colleges and institutions.....	7,875	.4	1,261	.2
Specialized and vocational.....	602,033	28.8	289,492	57.0
Total.....	618,900	29.6	294,640	58.0
Grand total.....	2,092,079	100.0	508,328	100.0
IV. Combined:				
Colleges and universities.....	1,235,301	59.0	147,583	29.1
Junior colleges and institutions.....	146,958	7.0	47,952	9.4
Specialized and vocational school.....	648,415	31.0	361,182	59.2
Unknown.....	61,405	3.0	11,611	2.3
Total.....	2,092,079	100.0	508,328	100.0

EXHIBIT III

METHOD PREVIOUSLY USED BY OE TO COMPUTE DEFAULT RATES

Prior to the development of the default estimation model OE computed default rates by comparing the amount OE has paid in claims for defaulted loans with the amount of loans on which the first payment has come due (matured loans). This computation requires the use of estimates because OE's records do not accurately show when loans mature (due to a lack of timely reporting by lenders). In addition, a time lag of several months frequently occurs between a student's default and OE's payment and recording of the claim.

Senator PELL. The grand total is not 18 percent, as you have, but the grand total of the average default rate is projected to be 24.3 percent.

Mr. BELL. Yes.

Senator PELL. So, these figures for which I realize the model is not yet complete would indicate the problem is even more acute than your own view is.

Mr. BELL. Mr. Chairman, we would not dispute those figures. We would indicate that we do not think they take into account our recent efforts, late as they have been—we are moving very aggressively on these. We believe that the actual loss rate, as compared to the claim rate, may be reduced as much as 12 percent.

Now, we hope that is not too optimistic, and maybe some of the staff could discuss the basis of that, if you want.

Senator PELL. I thought the trend was going the other way. The losses were getting worse and worse and not better and better.

Mr. BELL. We acknowledge that. We would say that our employment of staff and our intervention in this program is relatively recent, and it is getting more attention from us. And we are hopeful that we can turn that picture around considerably, but we do share the con-

cerns for this high rate and acknowledge that it is a source of great concern.

Senator PELL. There is more than just a default issue here.

If it is such a customary practice, we may be quibbling about a few percentage points one way or the other, if you have 18 percent and we have 24 percent. I am sure we both agree that the proprietary rate is about twice the general average; that what this is doing is also encouraging and inculcating into the young people, into the students, an element of rottenness at the very beginning, because they are starting out defaulting. And this, I think, will take its toll as these young people go through life. You start out your life on a rotten foundation, that life will have a hard time being jacked up straight again.

Mr. BELL. We acknowledge that, and we outline in the detail of our testimony some measures that we are going to be taking.

Senator PELL. Do you think we ought to get away from the loan concept?

Certainly, if the default rate is as high as 50 percent, 47 percent, in proprietary schools, would not one do better to have a grant concept, but not try to make loans that you know are not going to be repaid, which carries with it an intangible of moral harm as well as fiscal harm for the country?

Mr. BELL. The loan problem is certainly an acknowledged one by us. We are not ready to say yet that we would support abandoning the loan program and going to a grant program. We would like to have an opportunity within the next few months to see if we can build a better track record on this.

Senator PELL. In any program where a fifth of the people are violating the law, according to your figures, where a fifth of the people are cheating, then it becomes so widespread that they do not look on it as cheating, maybe.

In a way, we have seen how marihuana smoking has been looked at over the last few years, and when we tried to prohibit alcohol, many people did not honor that prohibition.

I am wondering if a program of this sort is just encouraging people to cheat?

Mr. BELL. We believe that as we work with the lenders and as we try to improve the management of this program, and we will acknowledge that that movement is overdue, that possibly we can make quite a difference.

Senator PELL. How many years has this program been in effect?

Mr. YORK. 1966, Senator.

Senator PELL. That is about 8 years.

I think your figures will show that the default rate was less in 1966 and 1970 than it is now. So the trend is going the other way.

Mr. BELL. That is true.

I think we have had a great upsurge of proprietary institutions during that time.

Senator PELL. Getting away from proprietary schools, I had this broken down among types of institution, and I notice the default rate in public institutions is 15 percent. The default rate in private institutions is 11.9, and proprietary is 47.6, and the combined total is 24.

You come out with 18. Either way, it is too darn much. It is going the wrong way.

Mr. BELL. Right, we acknowledge that, Mr. Chairman.

We would say that the additional staff that the Congress granted us is bringing on a new and more effective management program. And we feel it may help to reverse this trend.

As we say that, Mr. Chairman, we realize that we are very much on the spot in our administration of this program, and I say that, knowing that is so, as the new Commissioner.

Senator PELL. As some of you may recall, I have always been rather skeptical of the loan programs and SALLIE MAE and blocked it for a little while, but the majority of my colleagues did not agree with me.

I think the concept of loans for undergraduate education is fraught with problems and maybe we ought to get on with the idea of Basic Educational Opportunity Grant and the right of people to 16 years of education, a floor, not necessarily paying for Yale or some other-high-cost place, but a floor of education just like they have for 12 years at high school.

We could go on with that and get rid of a lot of employees and save the taxpayers some money and not have a fifth of our young people starting out in life as cheats.

I would think there would be some merit to it.

What would be your view?

Mr. BELL. We feel that a total program of student aid still should include a loan program, and we feel that we can improve the administration of this program, particularly with the added staff that has been granted.

I do not want to be overly apologetic for making too many excuses for the past performance in this program. I would say that the additional staff of 200 granted by the Congress came about only recently. So, the opportunity for this staff to become effective, to manage it better and work more closely with the elements where we think the problems are, we think will make a difference as it has in the brief time that we have been involved in it, in the numbers of collections we have been able to make, and in the many things that we are trying to do to tighten up the program.

Senator PELL. To be specific, you say increased staff. Do you have people on the payroll who are charged with going after the student and garnisheeing his wages and family's income in order to get the loan repaid, or how do you go after the loans?

Mr. BELL. We have our people doing various things in that regard, and I would like to ask Mr. York to explain that.

Mr. YORK. Senator, we have a growing collections staff which began with 26 people in January 1974.

By the end of this month, that staff will number approximately 135, who are dealing primarily with the collections activity.

Our collections effort does not proceed to the point of garnisheeing wages. We do not have that authority within the Office of Education. But we do pursue up to the point, attempt to establish a contact, and convince the student to begin to fall into a repayment mode.

We have been successful so far, although our experience is limited, in approximately 40 percent of the cases where we have been able to make contact.

Senator PELL. Do your employees make actual contact with the student?

Mr. YORK. Yes, sir, they make actual contact.

Senator PELL. So they are scattered across the United States then?

Mr. YORK. Yes. We have our collection staff housed in our 10 regional offices of the Department.

Senator PELL. That would be about three people a State on the average. I would think that is not a very large number, is it?

Mr. YORK. Well, the number of 135 is our first effort to move in the direction of what we believe will be the beginnings of adequate staff to pursue these.

We have estimated a collector can handle a certain number of accounts in a given year, and our experience would predict they can convert so many of those accounts into repayment status during the year.

Our staffing is based on a pretty hard look from a workload measurement standpoint of what we think we can do with collections activity.

But we must recognize this is just the beginning. We have only had ability to start hiring these people as of June of this year. We have about half, or a little better than half of that staff in place now.

Senator PELL. Would you submit for the record alongside these figures we have submitted to you from GAO where you think they are wrong and why you think they are too high?

It is not much we are quibbling about. You say 18 percent and I say 24. This is not too much of a difference.

[The material referred to and subsequently supplied follows:]

ANALYSIS BY OFFICE OF EDUCATION OF THE DEFAULT TABLE PREPARED BY THE
GENERAL ACCOUNTING OFFICE

The data on the table prepared by the General Accounting Office entitled "Eventual Default Rates By Type of School" is an accurate reflection of data taken from the Loan Estimation Model.

The model data is based on actual experience in the federally insured phase of the Guaranteed Student Loan Program and does not reflect data of loans guaranteed by State or private agencies. We are of the opinion that past experience can no longer be accepted as a basis for future prognostications. Too many things are changing.

For years we had virtually no collection or examination effort. We could not test the application of due diligence. Further analyses show a very high concentration of defaults in a few states, lenders and schools—far beyond that of similar institutions with similar problems. Concentration of resources in these areas, now that resources are becoming available, should reduce the defaults substantially. Also, the new proposed regulations permit action to withdraw program support from the worst offenders. This will also cut losses.

Since linear extrapolation from past experience (and this is the basis for forecasting by the Model) presumes no changes in operations, it does not form an adequate base even though it may be the only valid mathematical technique available presently.

Mr. BELL. Mr. Chairman, I do not think we could dispute the figures. They have used our loan estimation model that was developed in our office.

We think they are accurate.

The point I would like to make is that they do not take into consideration the intervention that has been very aggressive. And with new staff and with new regulations and with our moving to help the actual loss rate versus the claims in the default rate to be considerably different—in fact, in our testimony, part of which we have not been able to deal with here in detail, we suggest that the actual loss rate percentages may be even closer to 10 or 12 percent than these projections.

I would hasten to say that this takes into consideration the interventions that we have made and the data that we have has not been able to take that into consideration.

Senator PELL. I think one of the problems here has been the data.

As you know, this subcommittee has sought to get the specific information on this for several years now.

The first time we have gotten any hard figures were yours and from the GAO today, September 1974.

Do you agree with the fact that the default rate of the proprietary institutions is about twice that of the national average and about four times that of the private institutions?

Mr. BELL. Yes. We acknowledge that enormous rate, and we feel that our efforts, of course, ought to concentrate where the rate is the highest.

We discussed this in my office and discussed how we can turn the program around. We are certainly looking at what I would admit is a shocking rate with these institutions.

Senator PELL. The problem we face is to try to make sure that the students receive career education, vocational education, and at the same time make sure that they are not ripped off by these fly-by-night operators.

I am not sure if the blame here is not only proprietary schools, but also obviously, rests with the students as well, because if they default, some of the burden rests with them. They have an obligation.

Mr. BELL. We think our new regulations that will be enforced in a brief time will give us an opportunity to do a better job with this approval of these institutions.

Senator PELL. One specific question.

Student default, is that cranked into his credit rating in later life?

Mr. BELL. I am not sure of that.

Would you know, Mr. York?

Mr. YORK. Dave, would you address that specifically?

Mr. BAYER. Most commercial banks do belong to credit bureaus and work closely with them.

Under the terms of their contract that they have with credit bureaus, they would have to file with a credit bureau for a student who has defaulted on his loan.

We do not, at this point in time, directly from the Federal Government standpoint, notify credit bureaus.

Senator PELL. I would think that a student who takes loans should be made to understand that his credit rating in later life will suffer, and I think that if a student realizes he will not be able to buy a car on time, he might be more likely to repay the loan.

I am just wondering if we are going after these loans as hard as we should.

Mr. BAYER. We have been complying very diligently with the requirements of the Federal Claims and Collections Act and the joint standards issued thereunder by the Attorney General and the General Accounting Office in pursuing these students.

We have, as has been indicated, beefed up substantially our field staff to performance collections activity. Plus we have been working through issuance of computer printed letters, using tracing techniques to locate those who have been unable or unwilling to pay.

I believe that the efforts that are underway right now, and those that we project in the future, will have a significant effect in recovering these losses that the Federal Government has incurred, and will continue to incur for some time.

Senator PELL. To answer my question specifically, is any procedure in force so that a student who defaults on his loan is unable to buy an automobile on time?

Mr. BAYER. We do not have any specific procedures. Again, the lenders usually file these reports with the credit bureau.

Senator PELL. Could you repeat that sentence?

Mr. BAYER. The lenders, under the terms of agreement with the credit bureau, are required to report such defaulted students to the credit bureau. We do not have any such requirements.

Senator PELL. Can you think of any legislation we can write into law that would result in a tightening up so that the student is not encouraged to default, as is the case now?

Mr. BAYER. I think new regulations that we are working on will do much to help preclude defaults in the future and reduce substantially the incidence of defaults in the future.

Senator PELL. What regulations are those?

Mr. BAYER. We have some new regulations which we expect to have published in the Federal Register under proposed rulemaking procedures in the next few weeks.

These are designed primarily to regulate educational institutions. These regulations will establish requirements and procedures that schools and colleges will follow in the administration of the program, and further provide for detailed procedures for the limitation, suspension, or termination of those schools which do not comply with these requirements.

They set forth really two standards and requirements that educational institutions must meet to continue their participation in the guaranteed student loan program.

Senator PELL. It seems to me that this was asked to be done 2 years ago in the higher education bill. Why is it only just now, why are these regulations 2 years late coming out?

Mr. BELL. I believe I should respond to that, Mr. Chairman. I am deeply concerned about the whole matter of getting regulations out in a timely fashion.

As you recall, when my confirmation was before the Senate, many Senators, I think including you, Senator Pell, raised this question.

We are in the process now, pressing this very earnestly, and all I can say about it is that I think it is one of the highest priority responsibilities I have, as the new Commissioner of Education.

I am now checking the procedures that we have to follow. I am convinced that they take too much time and that we have a process that just has to be streamlined in order to get all clearances that we have to get through my office and through HEW, to get these regulations in force.

So I will just say that I acknowledge that the publication of these regulations is late, and will just say to the chairman that, as the new Commissioner, I know that this is a high priority concern, that I must work on, and that we must aggressively pursue.

I would say, just parenthetically, that we will have all of the requirements of H.R. 69 coming on at the same time that we have the Higher Education Act of 1972 to finish, and so I am not minimizing a bit and just saying that I pledge my very best efforts to move forward with this.

Senator PELL. We have been getting this barrage—it is not your personal responsibility in the past, but it is now—we get these barrages of words and it always startles me so much that the administration wants to cut programs, cut here and there, but it takes more than 2 years to develop a set of regulations that could save the wasting of a half million dollars.

I would think, it would cause the Secretary, who was previously the Director of the OMB, to wake up at night wondering about this ineffectiveness of his Department.

Mr. BELL. I just reiterate my deep concern with this, Mr. Chairman.

Senator PELL. The concern is reflected by the Senate, too.

I have to recess the hearing for a short while. There is a vote going on in the Senate Chamber.

[Short recess.]

Senator PELL. The hearing will resume. There will be some questions which we are going to submit in writing to you which we hope you will answer within the next few days.

[The information requested and subsequently supplied follows:]



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF EDUCATION
WASHINGTON, D.C. 20540

October 31, 1974

Honorable Claiborne Pell
Chairman, Subcommittee on Education
Committee on Labor and Public Welfare
United States Senate
Washington, D.C.

Dear Senator Pell:

Enclosed are responses to the seven questions you raised with regard to the hearing of Wednesday, September 18, on the Guaranteed Student Loan Program. As you also requested, we have reviewed the transcript of the hearing of Thursday, September 19, insofar as allegations are raised by the Guarantee Agencies.

The most significant allegation (page 27 of the transcript) relates to the statement of Commissioner Bell that, regarding default rates, we did not have comparable data on Guarantee Agency programs. The Guarantee Agencies are correct in indicating that they have been furnishing certain data on default rates to the Office of Education on a quarterly basis. The Office of Education has recently changed the formula for computing default rates. For this reason, while we do have data on Guarantee Agency default rates, they are not computed on the same basis and therefore, the Commissioner's statement that comparable data for the Guarantee Agency programs were not available is correct.

The only other allegation which we believe requires response is found on page 48 of the transcript and relates to the statement that half of the federally insured default problem "is coming from three dozen schools or so."

The most recent cumulative data on federally insured defaults paid shows that thirty-six schools account for 38 percent of all defaults. A school with several branches is counted only once in this total of 36. The number of schools which account for half of the federally insured defaults is 77.

Enclosed together with the responses to your questions of September 23 is an analysis of the default table prepared by the General Accounting Office and shared with the Commissioner by you at the hearing.

Sincerely yours,


Albert L. Alford
Assistant Commissioner
for Legislation

Enclosures

ANALYSIS OF THE DEFAULT TABLE PREPARED BY THE GENERAL ACCOUNTING OFFICE

The data on the table prepared by the General Accounting Office entitled "Eventual Default Rates By Type of School" is an accurate reflection of data taken from the Loan Estimation Model.

The model data is based on actual experience in the federally insured phase of the Guaranteed Student Loan Program and does not reflect data of loans guaranteed by State or private agencies. We are of the opinion that past experience can no longer be accepted as a basis for future prognostications. Too many things are changing.

For years we had virtually no collection or examination effort. We could not test the application of due diligence. Further analyses show a very high concentration of defaults in a few states, lenders and schools -- far beyond that of similar institutions with similar problems. Concentration of resources in these areas, now that resources are becoming available, should reduce the defaults substantially. Also, the new proposed regulations permit action to withdraw program support from the worst offenders. This will also cut losses.

Since linear extrapolation from past experience (and this is the basis for forecasting by the Model) presumes no changes in operations, it does not form an adequate base even though it may be the only valid mathematical technique available presently.

[Responses by Office of Education to questions raised by
Senator Pell]

- 1a. Has the Office of Education made any estimate of long-range cost to the Federal Government of the Guaranteed Student Loan Program?

The Office of Guaranteed Student Loans had made estimates of the long-range cost of the Program to the Federal Government, and these estimates are presented in the attached table.

- 1b. Assuming a continuation of present default rates, what will be the amount necessary to be appropriated for fiscal year 1976? 1c. Can you provide the Committee with estimates for fiscal years 1977, 1978 and 1979?

In developing the estimates for the fiscal years listed, the assumption of a continued increase in default rates was not followed. If such an assumption were made, the developed estimates would represent a strict linear extrapolation based solely on historical trends reflecting in no measure the proposed improved program management. Since programmatic and management improvements are already underway and since further positive action steps are anticipated, the assumption of a direct linear increase seems unacceptable. OE management anticipates several programmatic changes which should reduce the annual default rate and contribute to a slight but continued reduction in the cumulative default rate. The cumulative rate will be less responsive to these changes because of the large historical base upon which it is calculated and because of a stabilizing annual loan disbursement. In this Program, there are three types of defaults--defaulted loans, bankruptcies, deaths and disabilities. In determining reduced default costs only reductions in defaulted loans were considered because it is only on these defaults that management can exert any direct influence. Rarely, if ever, is any recovery achieved on bankruptcies or death and disabilities. The changes anticipated by management to reduce default costs to the Federal Government are:

- a) The enforcement of new and revised Program regulations,
- b) the effective use of available manpower through intensive training and development to achieve:
 - 1. higher collection returns;
 - 2. a reduction of the number of claims filed by lenders; and
 - 3. the intensification of our program compliance effort through on-site reviews of lenders, schools and guarantee agencies.

These changes are presently being initiated into the Program and their full impact potential should be realized in FY 1976 and will continually improve through FY 1979.

- 1d. How much of the appropriations are necessitated by interest payments, special allowances under the Emergency Student Loan Act, and defaults?

The attached table presents the estimated costs of the Program to the Federal Government broken out by those appropriated dollars required under the Higher Education Appropriation and under the Student Loan Insurance Fund. Included

- 2 -

in the Higher Education Appropriation are funds for payments of interest, special allowances and death and disabilities. Payments are made from the Student Loan Insurance Fund to cover all default claims, except death and disabilities. The reduced cost of the Program to the Federal Government under the Student Loan Insurance Fund is the result of a lower default rate, explained previously, and an increased and intensified collection effort producing increased collection receipts to match against estimated obligations.

2. There have been suggestions made that, since the Office of Education has little expertise in dealing with a program that is basically one of money and finance, its administration should be turned over to some other agency, such as the Department of the Treasury, also putting the expense for the Program under that budget item. What is the Office of Education position on this matter?

Because the primary impact of the Guaranteed Student Loan Program is in the furthering of a student's education and because overall responsibility for education has been legislated to the Office of Education, we remain fully convinced that the responsibility for the program ought to remain with the Office of Education and the Department of Health, Education, and Welfare. The location of this program within DHEW also assures that student loan policies will be coordinated, to the extent possible, with those affecting other Federal student assistance programs.

3. Is the understanding of the Senate that responsibility for administration of the Guaranteed Student Loan Program has been transferred from the Bureau of Postsecondary Education to the Deputy Commissioner for Management in order to improve the management of the Program. What steps are being taken to tighten up on the Program's administration?

The transfer of the Guaranteed Student Loan Program from the Bureau of Postsecondary Education to the Deputyship for Management has provided greater management visibility by elevating the stature of the program from the Division level to Office status with an Associate Commissioner reporting directly to the Deputy Commissioner for Management. Within the new reporting framework, programmatic duties have been functionally aligned and will provide a coherent structure for achievement of overall program goals.

Attached is a copy of the Federal Register for July 17, 1974, which further details the alignment of functions. The publication of revised regulations will implement major legislative changes in the Program resulting from the Education Amendments of 1972 and from Program experience. The most significant change will be the publication of regulations which will permit implementation of the Office of Education's authority to limit, suspend and terminate educational institutions from participation in the Program. These regulations were published as a proposed rule on October 17. The regulations package combines

- 3 -

programmatic implementation as well as the appeals procedure. The complete regulations package, essentially a re-write of the existing regulations, including the general provisions and requirements of guarantee agencies and lenders, will be published as a proposed rule later this fall.

Additional personnel resources were made available to the program from the FY 1974 regular and supplemental appropriations which will form the cornerstone from which to build a coherent program less amenable to abuses.

Finally, our new regulations on suspension, limitation, and termination will have a major impact on what schools will be permitted to participate in the program.

4. The committee has received information from the General Accounting Office concerning estimated default rates by type of institution. These figures were derived from a model developed by your Office of Planning, Budgeting and Evaluation. What input did the people responsible for administering the Guaranteed Student Loan Program have in the development of this model, and why was its creation necessary at this point in the program?

The need for the development of a computerized model for use in forecasting Guaranteed Student Loan Program budget requirements was recognized several years ago by program staff. The complexity and size of the rapidly growing program, and inability of staff to accurately predict appropriations needs for claims payments, created the need for such an undertaking. The Office of Planning, Budgeting and Evaluation (OPBE) in its role of support to program areas assumed the responsibility for the development of contract specifications for such a model in late 1972. While the program staff was not involved in the awarding of the contract to Systems Group, Inc., the staff has worked closely with and been consulted by OPBE in the development of the model. Program input was primarily on the administration and operations of the program with emphasis on data collection and processing problems, historical and other factors which could affect the completeness, quality, and interpretation of the data base. The staff did not provide any inputs on technical or methodological aspects of computerized model building.

5. It is the understanding of the Subcommittee that a number of schools act as lenders in the Guaranteed Student Loan Program. What additional steps does the Office of Education take in approving a school to act as a lender to its own students?

Within the Office of Guaranteed Student Loans, an Evaluation Committee has been established to review applications from educational institutions who wish to be approved as lenders in the federally insured phase of the Guaranteed Student Loan Program. This same committee also performs an annual review of educational institutions previously approved.

- 4 -

Applicant schools provide some 16 different exhibits designed to show the administrative capability and financial stability of a potential school/lender. Additional reports are obtained from up to seven different sources, both internal and external to the Office of Education. In the case of schools previously approved, additional reports are reviewed reflecting the school's administration of the program (i.e. default rate, complaint letters, etc.). These exhibits and reports are summarized by staff and reviewed by the Committee. The Committee then makes a recommendation to the Associate Commissioner as to the disposition of the application. If approved, the Contract of Insurance is forwarded to the school through the appropriate Regional Office of the Office of Education. In the notice of approval to the school, an annual dollar limit of new loans is established for the school. In cases where the application is disapproved, the applicant is advised in writing and informed of his rights to appeal.

6. In the Subcommittee's hearings last week on accreditation and eligibility, it became apparent that a number of schools use commission salesmen to enroll students on Guaranteed Student Loans. It is my personal feeling that this constitutes a grave potential abuse, as the salesmen are, in essence, getting a bounty for each student they are able to enroll, whether or not he is qualified to complete the course. What is the position of the Office of Education on the use of commissioned salesmen, and what steps are being taken to protect the Guaranteed Student Loan Program from abuses of this sort?

The Office of Education is currently exploring the possibility of issuing a regulation that would prohibit a school from using commissioned salesmen. Unfortunately, there have been no empirical studies conducted or evidence available that demonstrates the need for or justification for such a regulation. The Office of Education recognizes that there have been abuses conducted by some representatives of certain postsecondary educational institutions. However, it is not clear that the manner in which school employees are paid is the cause of the problem or whether it can be attributed to the overall administrative practices of the educational institutions. Another difficulty is that there are numerous ways (e.g. bonuses, profit sharing) in which the practices resulting from commissioned salesmen could be circumvented even if they were required to be placed on a salary basis. Finally, it appears that direct regulation of this business practice would fall within the jurisdiction of the Federal Trade Commission.

In the meantime, proposed regulations implementing Section 438(a), which were published in the Federal Register on October 17, 1974, should do much to eliminate abuses by educational institutions in their administration of the Guaranteed Student Loan Program, since they spell out the grounds on which the Commissioner will suspend, terminate or limit participation in the program by schools which abuse it.

- 5 -

7. In 1972, the Congress, at the request of the Administration, authorized the Office of Education to remove eligibility for participation in the Guaranteed Student Loan Program for an institution which was fiscally unstable or otherwise in violation of the regulations for the Program. This provision has not yet been implemented although more than two years have elapsed. Last week, an Office of Education witness, when questioned why no action had been taken to implement this provision, indicated that other matters of higher priority had taken precedence. In light of newspaper reports concerning gross abuses in the Program, why does the Office of Education believe that implementation of such a program is of such low priority?

It is not an accurate statement that the Office of Education has maintained a low priority on the issuance of regulations to implement the authority contained in the 1972 Education Amendments to limit, suspend or terminate the eligibility of educational institutions that violate Federal Regulations. The needs test required by the 1972 Amendments resulted in major problems in the summer of 1972 and the Congress thus deferred their implementation until March 1, 1973. Most of our efforts during that period of time were in redrafting forms and procedures dealing with the impact of the needs test requirement. This same provision of the law was further amended in the spring of 1974 which necessitated additional modifications to instructions provided the schools and lenders participating in the program.

For more than a year, the Office of Guaranteed Student Loans have been involved in a major rewrite of all regulations governing the program. This was a major undertaking which had to reflect not only all of the 1972 Amendments (as well as the 1974 legislation) but also the experience of program administrators since the regulations were last revised in 1970. However, the decision was made in the early summer of 1974 to extract those provisions governing educational institutions from the total package and to issue them under a separate procedure. The complexity and controversial nature of these regulations has required a considerable amount of time, not only of program administrators, but with the Office of General Counsel and key policy persons of both the Office of Education and the Department.

The Guaranteed Student Loan Program has been severely understaffed and it was not until the spring of 1974 that authority was provided by the Congress for a significant increase in the number of persons authorized to administer the program. Because of the severe staff limitations that have previously existed and in order to provide for the day-to-day administration of the program, it was not possible to issue these regulations prior to this time.

Attachments

63
25

OFFICE OF GUARANTEED STUDENT LOANSSummary of Federally Insured Loan Program
and
Federally Reinsured Loan Program
(Guarantee Agency Program)

	1976	1977	1978	1979
	(Estimated Amounts in Millions)			
<u>I. HIGHER EDUCATION APPROPRIATION</u>				
Interest Benefits	\$267.0	\$273.0	\$316.0	\$365.0
Special Allowance	182.0	221.0	210.0	188.0
Death and Disability	3.0	3.0	3.0	3.0
Total Obligations and Appropriations	<u>452.0</u>	<u>497.0</u>	<u>529.0</u>	<u>556.0</u>
<u>II. STUDENT LOAN INSURANCE FUND</u>				
Federal Insurance Program:				
Obligations (defaulted loans and bankruptcies)	\$155.0	\$149.0	\$115.0	\$118.0
Available receipts and carryover				
Insurance premiums	3.2	3.2	3.2	3.2
Collection receipts	25.8	66.5	88.0	100.0
Subtotal appropriation	<u>126.0</u>	<u>79.3</u>	<u>23.8</u>	<u>14.8</u>
Federal Reinsurance Program:				
Obligations (defaulted loans and bankruptcies)	90.0	65.5	80.5	67.5
Available receipts and carryover (collection receipts)	<u>14.0</u>	<u>17.0</u>	<u>20.3</u>	<u>30.2</u>
Subtotal appropriation	<u>76.0</u>	<u>48.5</u>	<u>60.2</u>	<u>37.3</u>
Total:				
Obligations	245.0	214.5	195.5	185.5
Available receipts and carryover	43.0	86.7	111.5	133.4
Total appropriation	<u>202.0</u>	<u>127.8</u>	<u>84.0</u>	<u>52.1</u>
<u>III. TOTAL APPROPRIATION REQUIRED</u>				
(Total Obligations Part I plus Total Appropriation Part II)	<u>\$654.0</u>	<u>\$624.8</u>	<u>\$613.0</u>	<u>\$608.1</u>

Note: The estimates for collections on defaulted loans assume that new personnel requested in FY 1975 (and disallowed by the Congress), as well as new positions to be requested in FY 1976, will be allowed.

HEW NEWS

U.S. DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

FOR RELEASE IN A.M. PAPERS
Thursday, October 17, 1974-- (Office of Education,
BAYER -- (202) 245-2350
(Home) -- (703) 273-3051

HEW-E55

New and revised rules to improve management of the Guaranteed Student Loan Program have been proposed by HEW's Office of Education.

In addition to reducing the amount of default claims paid by the Federal Government, the rules are designed more adequately to meet the needs of postsecondary educational consumers who borrow under the program.

The Guaranteed Student Loan Program, authorized by the amended Higher Education Act of 1965, makes it possible for students to borrow up to \$2,500 per academic year for postsecondary education. The loan principal, provided primarily by the private lending community, is insured by the Federal Government or guaranteed by a State or private nonprofit agency. To date, four million student-borrowers have received more than seven million individual loans amounting to more than \$7 billion through the program.

According to today's Federal Register, new compliance criteria would be established for participation in the program by educational institutions and procedures would be set forth for limiting, suspending, or terminating the participation of educational and certain lending institutions.

For example, educational institutions would be required to maintain and retain records of student borrowers for administrative and fiscal purposes, as well as to notify lenders and the Office of Education when a student graduates or withdraws from school. This would improve loan collections since lenders would be notified of changes in student status on a timely basis.

- MORE -

Schools and colleges would be required to establish equitable refund policies which would be applicable to school closures as well as student withdrawals. In addition, certain vocational schools would be required to determine, through examination or other means, that each student admitted for enrollment has the ability to benefit from the offered instruction.

The meaning of "withdrawal" would be clarified as it applies to correspondence study, and the definitions of "eligible institution" and "vocational schools" would be modified.

Existing regulations dealing with disbursements and repayments would be expanded. For instance, except with prior approval from the Commissioner, commercial lenders could not disburse a loan more than 30 days before tuition is due to be paid. If written permission were obtained from the borrower, a lender could send the loan proceeds directly to the school. However, the lender would be required to notify the student in writing when the disbursement was made. If the student did not matriculate, the funds would have to be returned immediately to the lender.

Schools which also are lenders could make early disbursements of funds to students to cover certain costs but only at their own risk, since default claims would not be paid to school-lenders should the student fail to matriculate. In addition, the proposed regulations stipulate that loans made by such lenders must be disbursed in multiple installments, based on the school's academic schedule.

This should assure that funds are available to the student throughout the academic period for which the loan is received. It also will reduce the amount of potential default for a student who withdraws from school early in the academic year.

- MORE -

HEW-E55

- 1 -

To be eligible for a loan for correspondence study, the student would have to be enrolled in a course that requires an average of at least 12 hours of preparation each week over any 4-week period. A student would be considered to have withdrawn from correspondence study if he failed to submit a lesson for 60 days or did not complete the course within 60 days following normal completion time.

Interested persons may submit written comments within 45 days. Public hearings are planned during the 45-day period in San Francisco, Chicago, and Washington, D.C. In accordance with a provision of the new educational amendments (Public Law 93-380) signed last month, these regulations also have been submitted to the Congress.

Written comments or requests for further information about the proposed regulations or hearings should be addressed to the Office of Guaranteed Student Loans, U.S. Office of Education, Washington, D.C. 20202.

* * *

[From the Federal Register, vol. 39, No. 138—Wednesday, July 17, 1974]

OFFICE OF EDUCATION

STATEMENT OF ORGANIZATION, FUNCTIONS, AND DELEGATIONS OF AUTHORITY

Part 2 (Office of Education) section 2-B, Organization and Functions, of the Statement of Organization, Functions, and Delegations of Authority for the Department of Health, Education, and Welfare is hereby amended to add a division structure to the Office of Guaranteed Student Loans to more effectively administer that Program. The statement under the heading Office of Management, Office of Guaranteed Student Loans is hereby deleted and a new statement added to read as follows:

OFFICE OF GUARANTEED STUDENT LOANS

The Office of Guaranteed Student Loans plans, directs and evaluates all administrative activities associated with the operation and management of a program of low interest long-term insured loans for college and vocational students under which loans made by commercial and other lenders are insured (or reinsured) by the Federal Government and insured by State and nonprofit private agencies. Provides for payments to reduce interest costs to student borrowers and payments of special incentive allowances to lenders including payment of claims on insured loans.

Division of Program Development. Responsible for program planning, development and coordination of matters relating to legislation and regulations. Coordinates Guaranteed Student Loan Program with other student financial aid programs. Conducts program analysis to provide recommendations for changes in legislation and/or regulations. Develops policies and procedures defining the operation of the Guaranteed Student Loan Program for lenders, schools, and guarantee agencies including the development and issuance of manuals and guidelines. Provides policy guidance to regional offices, guarantee agencies and various constituent groups in areas relating to legislation and regulations. Coordinates interpretation of legislation and regulations with the Office of General Counsel and other appropriate agencies. Coordinates compliance resolution.

Division of Operational Support. Responsible for internal operating policies and procedures relating to processing and programmatic activities to include insuring loans, paying interest benefits special allowances and claims, collection of defaulted accounts and day to day communication and personal contact with individual lenders, schools, guarantee agencies, and students. Provides operational support through document processing activities which are supportive to regional office operations, lenders, schools and guarantee agencies. Prepares internal program operating policies and procedures supportive to the internal (both headquarters and regions) operation of the Program. Monitors operations for consistency with national policies and standards. Assures adequate control of documents flowing both to and from the computer system and distributes computer outputs. Provides for effective management information reports including the monitoring of the Student Loan Insurance Fund.

Division of Program Systems. Responsible for the design of management systems, and the development of computer based information systems, in accordance with OE standards to accomplish the goals of the Guaranteed Student Loan System. This includes: conducts management analyses and making recommendations concerning future management systems development, consulting on internal policies, operations and program objectives and reviewing all procedures and forms developed within the program. Responsible for furnishing Guaranteed Student Loan Program management with systems information, guidance, advice and recommendations emerging from the overall work performed. Conduct highly complex management analyses and makes continuing systems assignments on internal operating policies and program objectives. Provides a single point management function for all the planning, development, and operation of data processing systems activities within the program. Establishes and issues overall system policy and allocates resources to systems activities. Resolves conflicting priorities and competitive demands for systems activities. Prepares requests for proposal and authorizes the procurement of outside commercially available services through contracts. Acts as Contract Technical Representative on program management consulting and systems contracts. Recommends systems budget and authorizes expenditures within the approved budget. Conducts liaison with the Automatic

Data Processing Branch who will provide all systems hardware engineering and production services.

Dated: July 10, 1974.

JOHN OTTINA,
Assistant Secretary for
Administration and Management.

[FR Doc. 74-16338 Filed 7-16-74; 8:45 am]

Senator PELL. One question came up in a hearing earlier. It concerned this business of salesmen selling programs on a commission basis.

It seemed to me not very proper that Government money or Government-guaranteed loans should be the product that a salesman on a commission basis is selling.

I was wondering if you had any views on this and, if so, what they were.

Mr. BELL. I share that view, Mr. Chairman. I think it is entirely improper. We hope that we can do something about that.

I have been shocked at what I have learned about some selling on a commission basis.

Senator Pell. Would that not be very simple to have just a regulation saying no loans will be extended to students at institutions where enrollment is on a commission basis?

Mr. BELL. It is my opinion that this would be possible. We could get counsel to advise us on it.

It is my opinion this would be possible, and it is one of the things we will be looking at very hard and aggressively.

Senator PELL. I would like to press you a little more.

There are a lot of words about being aggressive and all, but 2 years have rolled by, and I would like to know if you could make a commitment to this committee that you will move ahead with a regulation of that sort and see it is promulgated?

Mr. BELL. I will do that if I can get approval.

Senator PELL. If it is legal.

Mr. BELL. If I can get approval of the Secretary and those that I need to get approval of. I say that with full agreement of the concern expressed.

Senator PELL. Thank you very much. I apologize for the stop and start nature of this hearing.

With regard to the two sets of figures, you are going to give us your areas of possible differences?

Mr. BELL. One point, Mr. Chairman, if I may make it, that was in my testimony, but just in case it is not understood, the Office of Education deals with 24 States directly, 26 States have their own guarantee agencies, and so the data we are talking about is with the 24 States where the Office of Education directly insures loans.

I am sure you understand that from the testimony.

The 26 States have their own State or nonprofit private guaranteed agencies. As we said in the testimony, there is that distinction that we need to make.

Senator PELL. We are going to hear from the 26 States tomorrow. In these figures that are offered, do they cover all States, all 50.

Mr. BELL. No. Our data just deals with those States we deal with directly.

Senator PELL. You mean the figures for States could be better or worse, we do not know?

Mr. BELL. We do not know.

Senator PELL. How can we find out? Does anybody know?

I guess I will ask the witnesses tomorrow.

Mr. BELL. We are working on that. I could ask Mr. York to respond, if you care to take the time.

Mr. YORK. It is not quite a question of an absolute, not knowing, but the State programs from State to State do vary. They are not identical from State to State. They do not deal with identical types of schools from State to State. Neither do they deal with the same types of schools that are dealt with in the Federal program.

The matching of data is difficult to do. We are working on that very hard.

I think I should point out that the information that the General Accounting Office provided basically also comes from our loan estimation model. That deals with basically the Federal program and not with the data from the State agencies also, so this is limited to data from the 24 States who are under the Federal program.

Mr. BELL. I think it is fair to say we do not know whether that data is any better than this one or not.

Senator PELL. Thank you very much indeed. Thank you for being with us and being so patient.

Good luck to you, Mr. Bell, in the very tough job you face.

Mr. BELL. Thank you. I appreciate it very much.

[The prepared statement of Mr. Bell and other information subsequently supplied for the record follows:]

BEST COPY AVAILABLE

FOR RELEASE UPON DELIVERY

Statement by
Honorable T. H. Bell
U.S. Commissioner of Education
Department of Health, Education, and Welfare
Before the
Subcommittee on Education
Committee on Labor and Public Welfare
United States Senate
Wednesday, September 18, 1974
10:00 a.m.

Commissioner Bell is accompanied by:

Edward T. York, Jr., Deputy Commissioner for Management, OE

Kenneth A. Kohl, Associate Commissioner, Office of Guaranteed Student Loans, OE

David C. Bayer, Acting Director, Division of Program Development, Office of Guaranteed Student Loans, OE

Charles M. Cooke, Jr., Deputy Assistant Secretary for Legislation (Education), DHEW

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here to present testimony on the Guaranteed Student Loan Program. I am especially pleased since, for the first time since the passage of the 1974 supplemental appropriations, some convincing evidence of our progress is available to me today.

I would propose to concentrate my testimony on two key areas of the program: loan volume, and claims and defaults.

Briefly, my remarks will indicate that while the average dollar amount of loans is increasing, they can be efficiently serviced by the Office of Education. Also outlined are those factors affecting loan volume which the Office of Education considers critical. I will also address the interrelationship of claims, defaults, and collections as well as those administrative steps which promise to reduce these program costs.

The figures given in my testimony may differ significantly from past presentations. Valid statistical measures were not available previously to operate on the program data which was at hand. Initial use of the Loan Estimation Model brought about greater validity; this is the crux of the variations.

At this point, it is advisable to note that the Guaranteed Student Loan Program (GSLP) is composed of two segments--a Federal program and a private, non-profit agency program.

The Federal program deals directly with lenders, guarantees 100 percent of losses in this area and has full responsibility for collections,

Page 2

while the Guarantee Agency operation is based upon reinsurance. We pay 80 percent of losses, with the Guarantee Agency responsible for the remainder. The Guarantee Agency also has full collection responsibility.

With this in mind, I will begin by discussing loan volume.

Loan Volume

The two charts, Figures 1 and 2, show trends in the dollar amount of new loan commitments and in the number of new loan commitments for every fiscal year from 1966 until 1974. The graphs show the developments in the Federal and Guarantee Agency programs as well as the combined totals. These charts show that from Fiscal Year 1966 to 1972, volumes in both programs grew steadily. From Fiscal Year 1972, where the volume peaked, the volume in both programs has declined slightly to the point where it would appear that there is a leveling situation.

The GSLP relies entirely upon the availability of funds from the commercial lending community. In many respects, student loans have fared better than many sectors of the economy. I wish to express my gratitude to the lending community in general and thank them on behalf of the Office of Education. Their continuing dedication is gratefully acknowledged, especially in view of the fact of the unprecedented rise in the prime interest rate.

While, as in any credit program there is little hard data comparing the level for a student's credit with its availability, the increase in educational costs and the reduction in loan volume would seem to indicate that there is a credit scarcity for students, as is true in the economy generally. The effect of the leveling off of the number of new loans

Figure 1
ANNUAL VOLUME OF LOAN COMMITMENTS
FISL AND GUARANTEE AGENCIES

Page 3

FY 1966 - FY 1974

\$ of \$
(000,000)

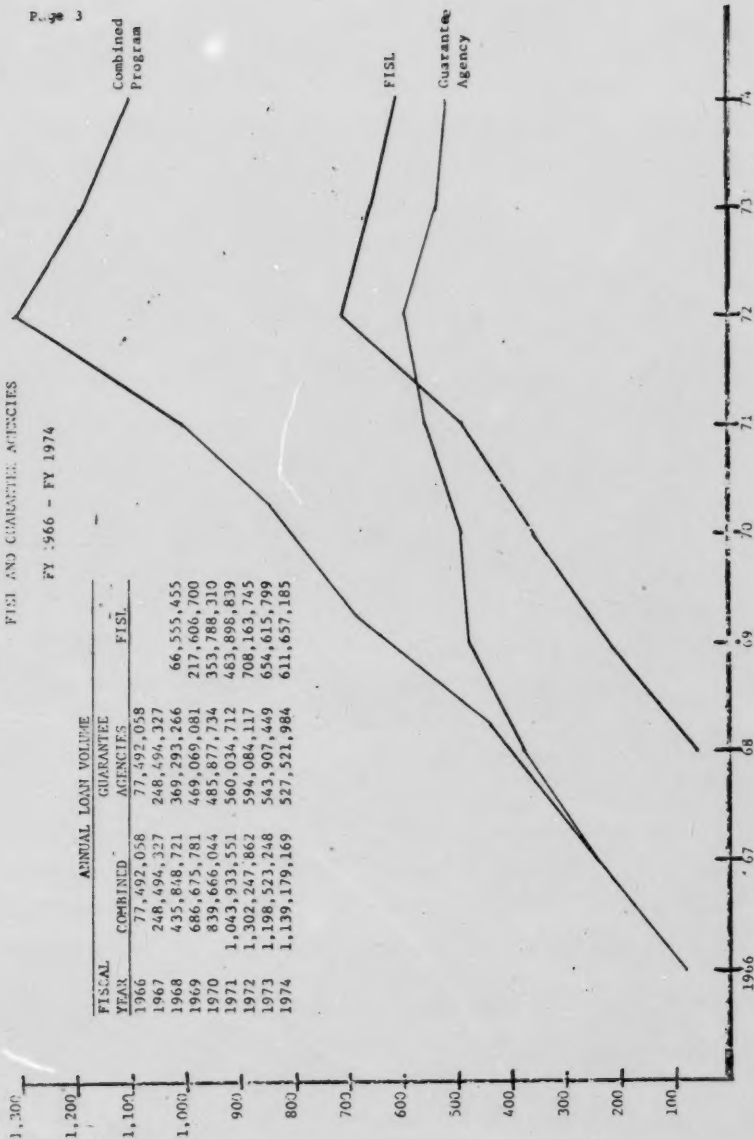
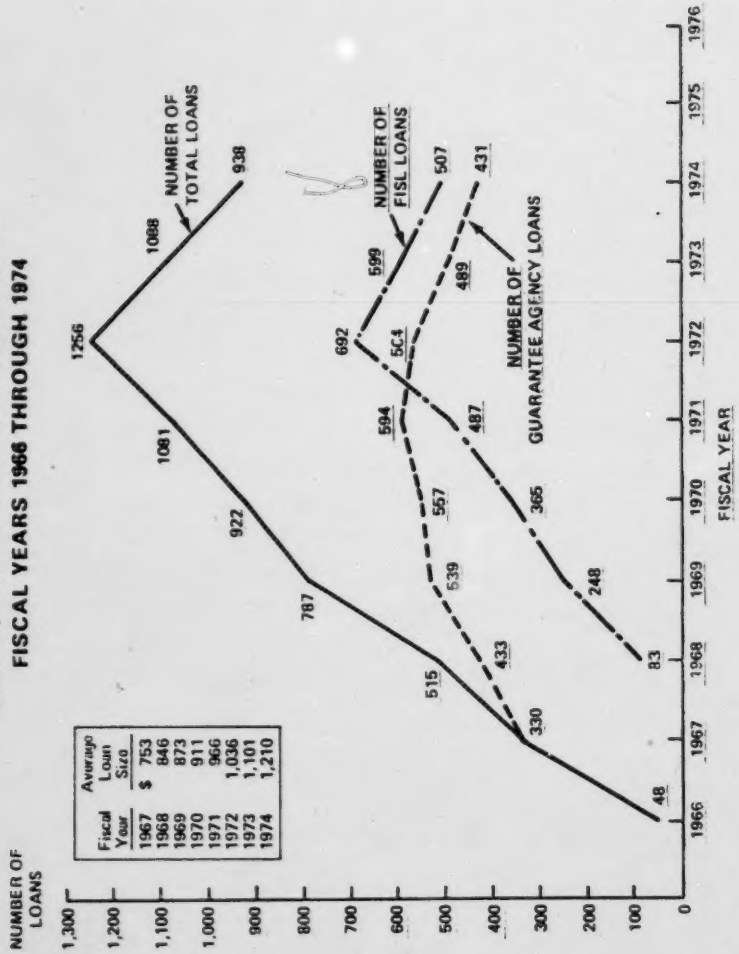


Figure 2

CHANGES IN NEW LOAN COMMITMENTS FISCAL YEARS 1966 THROUGH 1974



Page 5

and the continuing increase in loan size will be a small but steady growth in dollar amounts committed annually.

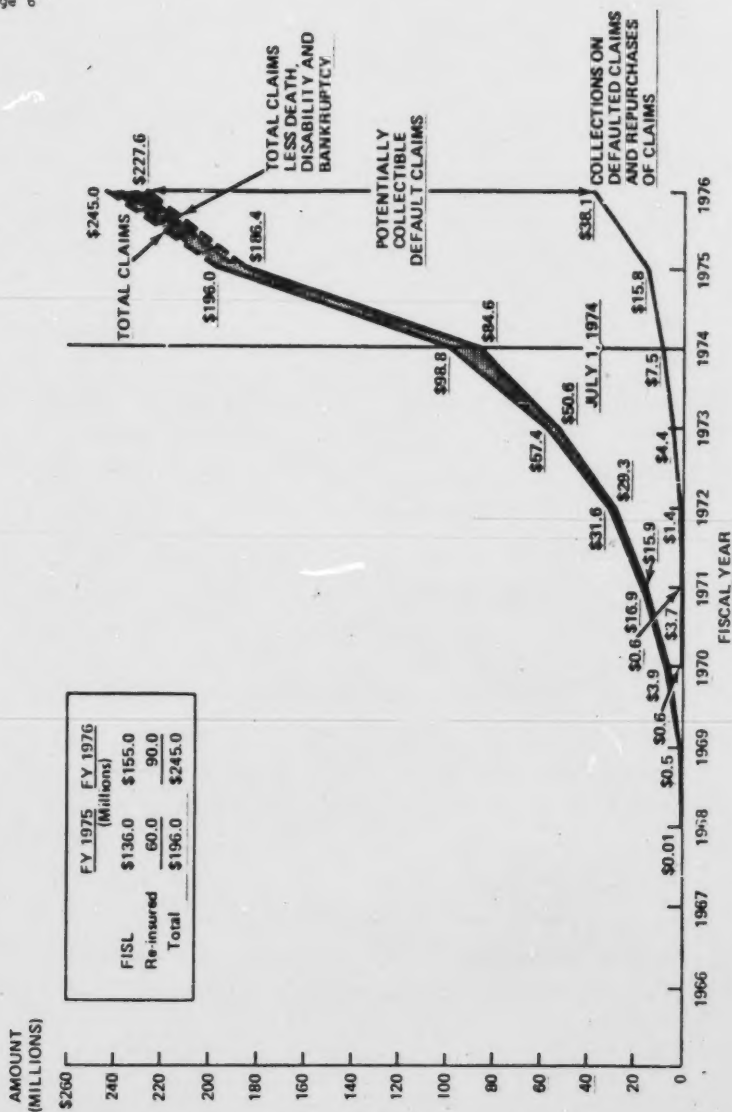
The program is seriously concerned with loan volume, the availability of loans to students, and the attendant impact on the educational community. There are some things we can do to encourage increased lender participation and better communication between all participants in the program. We are committing the new staff and resources appropriated to GSL last year to more effective management. Particular opportunities exist for gaining control over the payment of special allowance and interest subsidies on the one hand and over the treatment of claims and collections on the other. Indeed, we are currently re-structuring our efforts in these critical areas and should soon have positive results to show.

With these resources and management directions in mind, I would like to move to a discussion of defaults. It is important to emphasize that the remainder of this presentation deals with the Federal program only since comparable information on default rates from the Guarantee Agencies is not available at this time. The Federal program amounted to approximately 55 percent of new loan volume in Fiscal Year 1974.

Defaults

In order to progress toward a solution, we must first realize the scope of the problem. The default problem, with its attendant claims and collections activities, provides an example of the overwhelming need for an improved management effort. Few things, if any, have affected the public image of the program as has the default problem, which is growing rapidly (see Figure 3).

Figure 3
GROWTH IN CLAIMS PAYMENTS AND COLLECTIONS
(FISL AND RE-INSURED)



Page 7

A default legally occurs when a student borrower fails to make a scheduled loan payment for a period of 120 days and the lender, after attempting to effect collection, certifies the loan as uncollectable under its terms and conditions. The student borrower must have been out of school for not less than nine nor more than twelve months before the first payment is due. The efforts of the lender to establish contact with the borrower and to effect collection are covered under the legislated and regulatory areas of "due diligence."

The lender then presents a claim to the government. If the investigation of the claim finds the claim legally sufficient, the claim is paid. The rate at which such claims are paid, that is, the ratio of defaults to loans that are being paid properly (matured paper), has been the subject of controversy. Analysis performed by the program staff over the last several months using the Loan Estimation Model indicate the complexity of the problem. First, a distinction must be made between a claim and a loss of the proceeds of a loan.

When a claim is paid, the government has essentially purchased the loan; i.e., the loan is not simply written off. It moves from the collection process of the original lender to that of the Federal government. Action by the Federal government can, and does, cause loans for which claims were paid to revert to repayment status. Thus, the ultimate liability of the Federal government is based not simply upon the payment of a claim, but also upon the government's ability to re-activate loans. Therefore, program losses are represented not by the rate at which lenders are currently submitting claims, but rather at the rate of true

Page 8

loss--loss rate after the government has made its effort to collect the debt and failed. The word "after" is emphasized since, as will be seen, this rate is decreased by our collection activity.

Table 1 indicates a projected growth in the claims rate (line 4-C) for the Federal program from a current rate of 14.5 percent to an 18.5 percent figure in Fiscal Year 1975. However, the projected loss rate (line 7-D) will level off at about 12 percent for both years. This estimate is due to a forecasted substantial upgrading of our collection effort (line 7-B). Again I would reiterate that the figures in this chart are for the Federal portion of the program only.

A statistical study was conducted that indicates these default percentages would be further affected by the fact that there is an underreporting by lenders of loans to repayment (matured paper) of about 16 percent. This suggests, for example, that the actual loss rate percentages (line 7-D) should be closer to 10 percent than 12 percent.

The fact that we have a problem in this claims/default area is clear. We choose to accept the less optimistic figures for basing our projections and our program plan of action.

Although there is a problem in the area of defaults, this should be put in the perspective of total program costs as shown in Figure 4.

If you compare the total appropriated amount expended for defaults with that expended for interest subsidies and the special allowance, you will note that only 31 percent relate to defaults, while the interest subsidy and special allowance costs amount to almost 65 percent of the total cost of the program.

TABLE ISTUDENT LOAN INSURANCE FUNDFederally Insured Loan Program

<u>Insurance Commitments</u>	Fiscal Year <u>1974</u> (millions)	Fiscal Year <u>1975</u> (millions)
1. Loans Disbursed End of Year	\$2,666.0	\$3,309.0
2. Cumulative Matured Loans	952.0	1,481.0
3. Percent of Loan Disbursed that have matured	35.7%	44.8%
4. Total Claims Paid <u>1/</u>		
a. Yearly	74.7	136.0
b. Cumulative	138.0	274.0
c. Cumulative Claims Paid as a percent of cumulative Matured Loans <u>2/</u>	14.5%	18.5%
5. Defaulted Claims Paid <u>3/</u>		
a. Yearly	68.7	125.1
b. Cumulative	127.0	252.1
6. Accounts Converted to Re- <u>4/</u> Payment		
a. Yearly		49.4
b. Cumulative	15.1	64.5
7. Default Rate		
a. Defaulted Claims Paid 127.0		252.1
b. Less ACR	<u>-15.1</u>	<u>-64.5</u>
c. Net defaults	111.9	187.6
d. Default rate (net defaults/Matured Paper)12.0		12.7

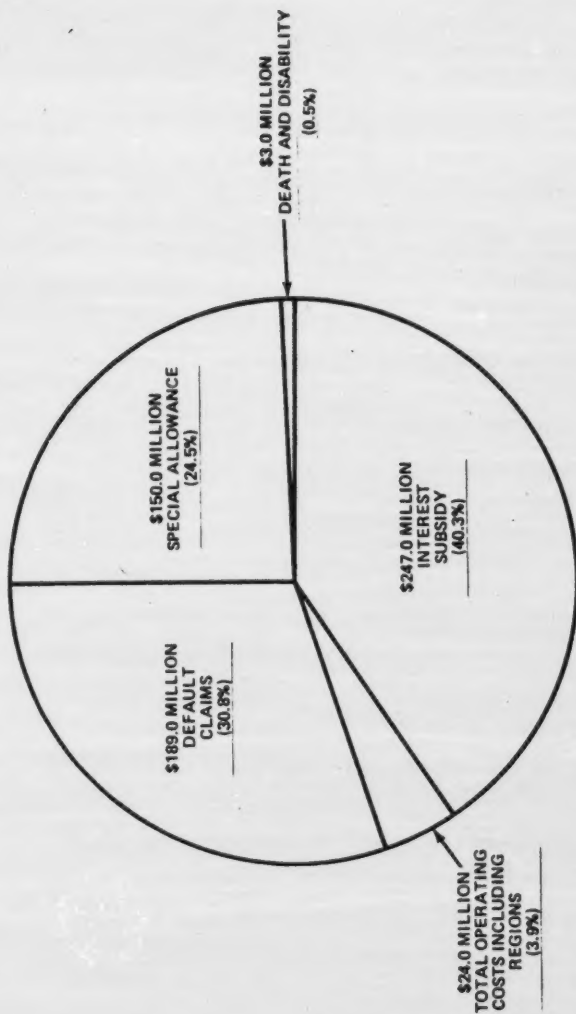
1/Represents payments on all defaulted loan, bankruptcy, and death/disability claims paid under FISL insurance commitments.

2/Represents a total paid comparison with cumulative mature loans. Mature loans are those that have converted from the "in school" to repayment status. Loans in repayment status can remain in repayment, default, or reach paid-in-full status.

3/Represents claims defaults by the borrowers that are potentially collectible.

4/Accounts converted to repayment are those on which our collector has obtained an agreement to repay from the defaulted borrower. The dollar amounts are estimated at \$1,000 per account.

Figure 4
REVISED FY 1975 APPROPRIATIONS REQUESTS



Note: The GSL budget requests of \$613 million represent about 17% of total Office of Education FY 1975 budget requests.

Page 11

Conclusion

In conclusion I would say that present trends can be reversed and a viable program can be implemented. We feel this to be essential. To understand this contention, one must appreciate the operating context which produced our problems.

Historically, OGSL has been heavily dependent upon both lenders and schools for implementation of its Federal program. Program staff was small--the program large. Further, data of the kind presented above was not previously available. Apparently, there were lenders who chose to submit claims rather than bear the expense of due diligence and there were schools who either inadequately screened students or in other ways took advantage of the system.

Our solution to OGSL's operational difficulties relies on these key factors: reliable information, proper regulations and adequate total resources.

The first factor is information. Clearly, we now have the data to detect where potential abuses are taking place. It is important to be able to isolate abuses accurately and fairly. Our data indicate a problem with proprietary specialized and vocational schools in the Federally Insured Loan Program. As a group, in Fiscal Year 1974 such schools accounted for 39 percent of loan volume and 57 percent of default volume. In spite of this, there are members of this group who have performed creditably. The answer is to isolate problem cases--accurately and on a timely basis. The same situation holds true in the case of lenders. We know the proportion of claims to matured loan volume by

Page 12

lenders. This allows us to isolate lenders who may be in need of pre-claims assistance in setting up and operating adequate due diligence efforts.

The second factor is regulations. The guidelines for what is expected of lenders and schools must be established and appropriate sanctions provided. Such regulation have been written, are presently in the final clearance process and should be published within the next few weeks. These regulations take a harder line than that previously expressed. We feel these regulations are vital to prevent abuses and every precaution has been taken to protect without obstructing the orderly mode of student loans. Their general content prescribes a series of possible actions up to and including removal from the program for a variety of abuses in such areas as refund policies, consumer information, misrepresentation and inadequate screening. Once these regulations are legally in effect, I shall take aggressive action to enforce their provisions.

The third factor is resources. The role of the staff is twofold-- to work with program participants to assure loan access and control throughout the life of a loan, and to directly assume collection responsibility for those loans that are in default. In essence, this requires that we attack the problem from the top and bottom simultaneously. This type of plan is ambitious, but no more ambitious than the program itself.

Further, there is the question of psychology. When we can show borrowers that we are aware of their debt and that we expect them to honor their obligations; when we can show lenders that we can pinpoint

Page 13

lack of due diligence; when we can show schools that high dropout and claims rates can terminate their program eligibility--the word will spread. As the Internal Revenue Service has long recognized, it is impossible to audit everyone. But if the audit mechanism is there--and is effective--most of us will play the game by the rules.

One final point is justified. The need illustrated by the \$7 billion already loaned is tremendous. We have been serving 1 million students per year who are dependent at least in part on this program for their education. We should remember that the losses can be minimized through adequate management. We continue to be enthusiastic regarding the future of the Guaranteed Student Loan Program and ask for your continued support.

Thank you for your time and attention. My staff and I will be happy to respond to your questions.

BEST COPY AVAILABLE

41



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF EDUCATION
WASHINGTON, D.C. 20002

NOV 29 1974

Honorable Claiborne Pell
United States Senate
Washington, D. C.

Dear Senator Pell:

We are pleased to report that Guaranteed Student Loan Program loan volume has increased significantly since implementation of the legislation (P.L. 93-269) which changed the basis for determining a student's eligibility for Federal interest benefits.

Data available for the first quarter, July 1, 1974, through September 30, 1974, for both Guarantee Agency and Federal Programs indicate increases in both number (12.7 percent) and dollar amount (22.8 percent) of loans over the volumes processed during the same period a year ago. Enclosed is a month-by-month national summary of data for each program and quarterly comparison summaries by State for the Federal and Guarantee Agency Programs.

We shall continue sharing major developments in the Guaranteed Student Loan Program with you.

Sincerely yours,

K. A. Kohl
Associate Commissioner
Office of Guaranteed Student Loans

Enclosures

484
491

GUARANTEED STUDENT LOAN PROGRAM

Loan Volumes Under Student Loan Amendments of 1974

The first quarter of Guaranteed Student Loan Program operations under the new Student Loan Amendments of 1974 indicate increases in both number and dollar amount of loans over the volumes processed under legislation previously in effect.

For the combined Federal and guarantee agency programs, volumes for the first quarter of Fiscal Year 1975 showed increases of 12.7 percent in the number of loans and 22.8 percent in the dollar amount of loans over the same period of Fiscal Year 1974.

Increases for the Federal program alone for the first three months of Fiscal Year 1975 were 15.7 percent for number and 26.5 percent for amount of loans over the same 1974 months.

Slightly lower gains were experienced under the guarantee agency program between the two quarters of Fiscal Years 1975 and 1974. The number of loans was up 10.5 percent and the dollar volume 20.0 percent.

Actual volumes are shown in the table below.

	NUMBER OF LOANS		CHANGE FY75/74	AMOUNT OF LOANS		CHANGE FY75/74
	FY 1975	FY 1974		FY1975	FY1974	
<u>JULY</u>						
Federal Program	43,211	46,750	(7.6)	57,978,656	58,643,001	(1.1)
G. A. Program	60,113*	43,348	38.7	82,826,067	57,587,715	43.8
TOTAL	103,324*	90,098	14.7	140,804,716	116,230,716	21.1
<u>AUGUST</u>						
Federal Program	67,100*	58,455	14.8	94,338,906*	72,711,932	29.7
G. A. Program	95,417*	94,258*	1.2	133,406,401*	118,370,137*	12.7
TOTAL	162,517*	152,713*	6.4	227,745,307*	191,082,069*	19.2
<u>SEPTEMBER</u>						
Federal Program	75,556	55,495	36.1	103,078,482**	70,479,598	46.3
G. A. Program	77,736**	73,565	5.7	106,354,756**	92,802,603	14.6
TOTAL	153,292**	129,060	18.8	209,433,238**	163,282,201	28.3
<u>JULY-SEPTEMBER</u>						
Federal Program	185,867	160,700	15.7	255,396,044	201,834,531	26.5
G. A. Program	233,266**	211,171	10.5	322,587,219**	268,760,455	20.0
TOTAL	419,133**	371,871	12.7	577,983,263**	470,594,986	22.8

* Revised

** Preliminary

FEDERAL INSURED STUDENT LOAN PROGRAM

Loan Volume
July, August, September 1975/1974

	NUMBER OF LOANS		PERCENT CHANGE 1975/1974	AMOUNT OF LOANS		PERCENT CHANGE 1975/1974
	1975	1974		1975	1974	
ALABAMA	4,220	3,399	24.2	5,447,453	3,769,440	44.5
ARIZONA	2,510	1,965	27.7	3,522,717	2,778,274	26.3
CALIFORNIA	23,656	15,677	50.9	35,643,073	20,951,447	70.1
COLORADO	9,991	5,132	94.7	16,223,186	8,107,298	100.1
D.C.	1,013	554	82.9	1,690,533	879,445	92.2
FLORIDA	7,078	5,344	32.4	10,686,148	7,652,310	39.6
HAWAII	1,016	817	24.4	1,542,137	1,149,027	34.2
IDAHO	655	704	-7.0	816,306	872,580	-6.5
INDIANA	9,745	7,710	26.4	14,149,356	9,831,932	43.9
IOWA	6,715	5,674	18.3	9,252,330	6,944,559	33.2
KANSAS	3,553	3,171	12.0	5,149,692	4,181,906	23.1
KENTUCKY	3,133	2,726	14.9	4,464,505	3,687,579	21.1
MINNESOTA	8,710	6,675	30.5	12,512,700	8,488,045	47.4
MISSISSIPPI	1,986	2,082	-4.6	2,735,657	2,502,118	9.3
MISSOURI	4,932	4,070	21.2	7,147,010	5,230,615	36.6
MONTANA	1,173	900	30.3	1,699,285	1,107,112	53.5
NEBRASKA	3,125	2,661	17.4	4,413,231	3,506,696	25.9
NEW MEXICO	1,890	1,457	29.7	2,389,557	1,712,379	39.5
NORTH DAKOTA	4,227	2,719	55.5	4,164,827	3,081,918	35.1
SOUTH DAKOTA	3,108	2,686	15.7	4,228,977	3,189,564	32.6
TEXAS	19,372	19,424	-0.3	24,089,860	24,413,886	-1.3
UTAH	738	930	-20.7	1,214,496	1,271,002	-4.5
VERMONT	466	476	-2.1	621,716	607,279	2.4
WASHINGTON	3,392	3,481	-2.9	4,739,600	4,469,729	6.0
WEST VIRGINIA	2,144	2,166	-1.0	3,082,096	2,849,812	8.2
WYOMING	312	186	67.7	513,576	256,549	100.2
AMERICAN SAMOA	18	11	63.6	35,200	24,251	45.1
GUAM	1			1,500		
PUERTO RICO	2,313	1,347	71.7	3,008,887	1,641,633	83.3
TOTAL						
FISL States	131,192	104,144	26.0	185,185,611	135,158,385	37.0
All others	54,675	56,556	-3.3	70,210,433	66,676,146	5.3
TOTAL	185,867	160,700	15.7	255,396,044	201,834,531	26.5

GUARANTEE AGENCY PROGRAM

Loan Volume
July, August, September 1975/1974

	NUMBER OF LOANS		PERCENT CHANGE 1975/1974	AMOUNT OF LOANS		PERCENT CHANGE 1975/1974
	1975	1974		1975	1974	
ARKANSAS	1,824	1,883	-3.4	1,988,248	1,918,129	3.7
CONNECTICUT	11,919	8,911	33.8	16,923,153	12,894,781	31.2
D.C.		5			5,300	
GEORGIA	4,992	4,008	24.6	6,197,349	4,762,663	30.1
ILLINOIS	13,509	10,395	30.0	18,977,631	13,630,257	39.2
LOUISIANA	3,330	2,626	26.8	4,088,304	2,791,901	46.4
MARYLAND	3,127	3,109	0.6	4,137,950	3,794,434	9.1
MASSACHUSETTS	14,234	12,145	17.4	20,841,450	16,451,110	26.7
MICHIGAN	7,067	5,832	21.2	8,584,972	6,729,579	27.6
NEW HAMPSHIRE	1,373	1,197	14.7	1,657,885	1,344,030	23.4
NEW JERSEY	21,936	20,082	9.2	34,726,334	29,689,628	17.0
NEW YORK	60,681	57,328	5.8	85,635,614	75,520,465	13.4
NORTH CAROLINA	1,825	2,103	-13.2	2,176,989	2,077,948	4.8
OHIO	9,349	7,657	22.1	14,471,470	10,406,282	39.1
OKLAHOMA	2,016	2,413	-16.5	1,923,828	2,248,328	-14.4
OREGON	2,147	2,236	-4.0	2,553,764	2,451,885	4.2
PENNSYLVANIA	40,920	39,311	4.1	59,494,493	51,087,908	16.5
RHODE ISLAND	3,759	2,864	31.3	4,946,329	3,582,283	38.1
TENNESSEE	2,363	2,331	1.4	3,356,200	2,868,071	17.0
VERMONT	1,279	1,090	17.3	1,527,028	1,294,059	18.0
VIRGINIA	6,141	5,336	15.1	8,133,638	6,197,088	31.2
WISCONSIN	13,453	11,552	16.5	13,341,839	9,994,242	33.5
USAF	6,002	6,758	-11.2	6,902,551	7,020,084	-1.7
TOTAL	233,266	211,171	10.5	322,587,219	268,760,455	20.0

Based on oral figures for September 1975

Senator PELL. We have considerable time pressure because I will have to leave again at the latest at 12:50 and conclude the hearing then.

Could the panel representing the Student Loan Marketing Association, Mr. Fox and his colleagues, come forward?

Please introduce your colleagues.

STATEMENT OF EDWARD FOX, PRESIDENT; TIMOTHY GREENE, VICE PRESIDENT AND GENERAL COUNSEL; AND WILLIAM SIMMONS, VICE PRESIDENT FOR MARKETING, A PANEL REPRESENTING THE STUDENT LOAN MARKETING ASSOCIATION

Mr. Fox. I have at the table with me my vice president and general counsel, Tim Greene, on my right. And on my left, no stranger to these proceedings, is Mr. William Simmons, vice president for marketing, many years associated with the program at HEW.

At the beginning, I would like to apologize for the absence of three of our board members, Mr. Edward McCabe, Mr. Joseph Barr, and Mr. Allen Purdy.

Mr. McCabe is out of town on a business trip. Mr. Barr as you are aware, is busy with the Franklin Bank, and Mr. Purdy, who is recovering from a heart attack, is coming along very well, and wished very much to be here. He will be very active again in the next month or so.

The genesis of SALLIE MAE goes back to the 1972 amendments to the Higher Education Act of 1965 in which Congress created a secondary market in the form of the Student Loan Marketing Association.

SALLIE MAE was created as a "for profit" Government chartered privately owned corporation to provide liquidity, for the Guaranteed Student Loan Program.

The President of the United States appointed a 21-member board in late September 1972, including financial, 7 educational and 7 members in the public interest.

That board held its first meeting in the spring of 1973. I became the first appointed official and came onboard in late spring.

Senator PELL. Would you give me something of your own background? Were you a civil servant, or what were you doing before? Were you in banking?

Mr. Fox. I had been the manager of investments, and an officer of Mobil Oil Corp. and a vice president of Studebaker-Worthington Corp. I came to Washington in 1970 as director of finance of the Federal home loan banks, spent 6 months at the Department of the Treasury as head of the Government task force to implement revenue sharing, and then became the first elected president of Sallie Mae in late spring 1973.

We started operations in the early fall of 1973, and through today have approximately 11 months of operating history, even though legislation creating us is approximately 2 years old at this time.

The board has been most active. There have been more than a dozen meetings in the 18 months since the board had been selected. It is an active, working board, and has taken a very dynamic interest

both in the means and the implication of the financing of the guaranteed loan program, and the impact that SALLIE MAE might have on the program.

The first responsibility given to the board of directors was raising some capital and getting actively involved as quickly as possible in support of the guaranteed student loan program.

In that regard, the first priority was to implement a stock issue to the approximately 20,000 eligible purchasers of our shares. This group is made up of financial and educational institutions who are eligible lenders under the guaranteed student loan program.

In the spring of 1974, SALLIE MAE was able to raise \$25 million, selling our stock to approximately 550 institutions.

These institutions, by our best reckoning, make up approximately a third to half of the volume of guaranteed student loan program.

Mr. Chairman, we are impressed by the fact that at a time when the capital markets in this country are in disarray—the stock market is down from a thousand to 600 as measured by the Dow Jones average—we are the only new company equity issue of any size sold in the United States, through an underwriting syndicate in 1974.

This recognition on the part of the educational and financial institutions in the program is very satisfying and gratifying to us.

We have \$25 million of capital accounts in our corporation right now.

In addition, we have raised approximately \$225 million through the sale of our short term notes to the Federal Financing Bank. We are pleased with our association with the Federal Financing Bank. Currently we have \$250 million in total funds to invest in our programs.

The SALLIE MAE board approved, under instruction from the Congress and legislation, in October 1973, a warehousing program. This is one of the program authorities that has been granted to the association.

Warehousing, in the simplest sense, means lending, to eligible financial and educational institutions, dollars to be reinvested in the guaranteed student loan program, collateralized by loans already on their books.

I am pleased to report that in our first 11 months of operation, we have approximately \$200 million of loans or commitments outstanding, and with indications of interest for another \$35 million.

Certain institutions less interested in our programs in the past, such as savings institutions, are now applying for advances. We have many applications from savings banks and savings and loan associations, who desire to continue participating in the guaranteed student loan program and who find SALLIE MAE's low-cost source of funds attractive.

We are very pleased with that.

The second part of our business approved by our board under instruction from your legislation is a purchase program. This has proven more difficult to get started.

Purchasing means responsibility for servicing. We also have to be responsible for the other problems implicit in the program as owners. We have to have control of the millions of pieces of paper that we will ultimately own, have to be able to account for them,

indeed have to be able to account to the Congress, to the Treasury, and to HEW, to whom we are accountable for our programs and for our success or failure.

Most importantly, the function of servicing has been something with which we have been most concerned. We have decided to buy loans subject to third party servicing, and are very pleased to announce today, that just today, by coincidence, we signed our first servicing agreement with a financial institution, the First National Bank of Minneapolis, and that we are buying for our portfolio loans from that institution this week.

We are hoping that by buying, subject to our own conditions of servicing and under our own conditions of origination procedure, that we will have a positive impact on the program; that those people who choose to do business with us will be required to adhere to our standards of origination and servicing, having a meaningful impact on the underlying program.

We think that over the next few years, the purchase program will be larger than the warehousing program, but we expect to offer both options to eligible lenders consistent with the statute.

I would like to point out, in concluding, that we have a very modest-sized staff. We have been able to accomplish the raising of our capital and the movement of more than \$200 million into the student-loan marketplace without the involvement of any Federal dollars whatsoever; that we have covered our costs through our own internally generated earnings.

We have met all of our expenses without Federal appropriation of any kind. I am pleased to report, after 11 months of operation, that we are in the black and hope to stay so.

The board feels a strong sense of loyalty to the guaranteed student loan program, a strong sense of loyalty to making SALLIE MAE a successful, for profit, partnership between the Government and private business. In the long run, the effectiveness of SALLIE MAE, prudently and conservatively managed as a business, will have a positive impact on the program as we upgrade servicing and origination procedures, and provide liquidity to lenders.

I am encouraged at this point, and I would like to reflect that encouragement to you.

Senator PELL. Thank you.

What effect does the default rate have on your balance sheet?

Mr. Fox. As of this moment, we do not own any loans, sir.

We will be owning loans in about 2 days. As owner, the default rate will have the same impact on us as it does on current lenders. We will have to be certain that our procedures are adequate enough to properly service, to try to obtain maximum repayment. And if we cannot get repayment, we will have to make a claim to the appropriate office of HEW.

Senator PELL. Will you use the same personnel to try to collect your loans that the Government talked about before, the staff of 135 people, or will you have a separate collection staff?

Mr. Fox. We will be initiating procedures, servicing procedures, that we think are significantly more diligent than that which we believe is currently being done around the country.

We are actually outlining—and I would like to make a part of the record a copy of the servicing document—we are outlining the pro-

cedures by which the institution who does the servicing for us must remain in contact with the student, spelling out the frequency of that contact, the methodology of that contact.

We do not want to lose, in this mobile society, the contact with that student and, unfortunately, have defaults for that reason.

We are actually spelling out the diligence that we think must be undertaken in the loans that we own. I know Mr. Simmons, who has been in this business for a number of years and has been a banker, feels that this is somewhat higher level of servicing, higher level of diligence than was currently applicable countrywide as a standard.

Senator PELL. To answer my question, will you have people collecting directly from you, or will you be dealing through the institutions?

Mr. Fox. The actual servicing will be done by third party servicers.

Senator PELL. If you have 24-percent default rate and the average does not go down—I believe it is continuing to go up—but let us say if it goes down a certain amount, say 20-percent default rate, would that not soon have a very bad effect on your own economic stability?

Mr. Fox. To the extent that the loans that we buy are not collected, and to the extent that the insurance is not honored by HEW, it would have an impact on our balance sheet. Therefore, we are making every effort to screen the loans we buy, based on prior default history, to assure or to hopefully protect our corporation, to try to upgrade the quality of the assets in our portfolio, and hopefully not to be placed in a position where we suffer grievous losses from default.

We are most concerned with the level of default and will be looking at the experience of prospective sellers.

Senator PELL. What do you think of the idea of cranking in a bad credit rating when they do not get repaid?

I am sure all the students who have defaulted, or the majority, have bought an automobile on time.

Mr. Fox. Speaking for myself, rather than for the corporation, I think anybody who defaults on an obligation is creating a track record for themselves that is going to follow them, and I think it is only a question of time before it becomes a part of their permanent record and impacts their ability to raise credit for, as you point out, a car or a home or something else.

Senator PELL. What about the student who declares bankruptcy, how do you cope with that?

Mr. Fox. Again speaking personally, I have seen Senator Percy's amendment in which he suggests that bankruptcy not be a cure for the obligation for a certain number of years.

From a purely business prospective, that would seem to make some sense.

We are certainly going to have to go to our board and find out what their thoughts are on these subjects.

Senator PELL. Thank you very much.

I apologize for the time pressures here.

We will submit a few questions to you in writing.

I apologize for the inconvenience you have all suffered.

Thank you very much.

Mr. Fox. Thank you.

[Information subsequently supplied for the record follows:]

STUDENT LOAN MARKETING ASSOCIATION

SUITE 400

1776 F STREET, N. W.

WASHINGTON, D. C. 20006

TELEPHONE (202) 788-1834

EDWARD A. MCCABE
CHAIRMAN

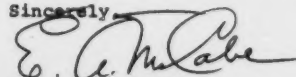
November 21, 1974

The Honorable Claiborne Pell
Chairman
Subcommittee on Education
Committee on Labor and
Public Welfare
United States Senate
Washington, D. C. 20510

Dear Senator Pell:

This is in further reference to your letter of September 23, 1974, to Edward A. Fox, President of Sallie Mae. For the Board of Directors of Sallie Mae, responses to your questions are attached. We appreciate the opportunity to respond, and if you or any member of your staff have any further questions, please let us know.

Sincerely,


Edward A. McCabe

Attachment

RESPONSES TO QUESTIONS CONTAINED IN
SENATOR PELL'S LETTER OF SEPTEMBER 23, 1974

1. QUESTION

Suggestions have been made that alternate secondary market mechanisms or methods of providing additional capital for student loans, in addition to the Student Loan Marketing Association, are necessary. Do you feel that this is true, or can the organization handle the job of increasing availability of student loan assistance?

ANSWER

Sallie Mae was created by Congress to provide a nationwide secondary market for insured student loans. To this end, the corporation was given specified statutory authority, including the authority to issue debt obligations through June 30, 1982, with the full faith and credit of the United States. As discussed in response to Question 2 below, we believe we have the capacity to provide financial resources required to meet the liquidity needs of both educational and financial institutions participating as lenders in the Guaranteed Student Loan Program. The statute grants the corporation broad authority to develop and implement secondary market activities. We have already established those activities and are in the process of expanding them. We see no need, based on experience thus far, to establish other mechanisms.

2. QUESTION

In this time of escalating inflation, interest rates are going higher and higher. How has the current market situation affected the Student Loan Marketing Association in getting the organization off the ground? Have you had any difficulty in selling shares in order to get necessary capital?

ANSWER

While financial market conditions have obviously been difficult, the Corporation, after having once withdrawn a stock issue in August, 1973, successfully concluded the sale of 166,667 shares of its common stock at \$150 per share in the spring of this year. The proceeds of approximately \$24 million from this sale has provided the initial capital

-2-

of the corporation. The fact that the offering was successfully made in adverse market conditions is an indication of the strong support for Sallie Mae by participants in the Guaranteed Student Loan Program.

As to "getting the organization off the ground" we have successfully launched our warehousing and purchase programs. We were able to offer warehousing advances to educational and financial lenders at attractive rates, compared to alternative sources of financing, during the recent period of credit stringency. Since the Warehousing Advance Program was first announced in October, 1973, the corporation has advanced approximately \$200 million. We anticipate that this program will continue to be attractive to participating institutions. The corporation recently purchased its first student loan portfolio of approximately \$2 million from the First National Bank of Minneapolis. We are currently negotiating for additional purchase arrangements with other lenders.

We have obtained our funds for the warehousing and purchase programs principally through the sale of our guaranteed debt obligations, of which \$205 million are currently outstanding.

3. QUESTION

The Education Subcommittee does not have the expertise of a banking committee. In enacting the Student Loan Marketing Association two years ago, we relied upon the advice of others more expert in the banking field to create the Association. Do you believe that any changes are needed in the authorizing legislation to make operation easier or more efficient? We would welcome any suggestions you might have for technical legislative changes.

ANSWER

The Board of Directors believes that our authorizing legislation is essentially sound and has worked well in practice. For this reason, we do not believe any legislative changes are needed at this time.

4. QUESTION

Under the Guaranteed Student Loan Program, schools, as well as lending institutions, may be lenders. Do you deal differently with schools as lenders than you do with banks and other lending institutions?

ANSWER

Basically, no. The corporation's business relationships are with "lenders", as defined in the law. The programs of the corporation are, as a matter of Board policy, equally available to all holders of insured student loans whether they be school lenders or financial institutions. To the extent that there are any differences in treatment between educational and financial institutions in our programs, these turn principally on financial considerations and their implications for us as a private corporation. One example of the type of difference that can occur arises in our warehousing program where, in order to protect the integrity of the collateral under a warehousing advance, it is the general practice to require an educational institution to place the collateral for the advance in the custody of a safekeeping agent. It is not ordinarily necessary to take these same steps with respect to warehousing advances made to regulated financial institutions -- since those institutions are accustomed to and have facilities for this type of transaction and are subject to supervision and regulation of State or Federal banking agencies.

Also, the Sallie Mae Board has generally required that a participant in its programs hold at least 100 shares of Sallie Mae common stock. But the Board recognized that this requirement could impose a greater burden on educational institutions than financial institutions. Accordingly, an educational institution having a gross annual income of less than a million dollars from tuition, fees and room and board need only acquire 50 shares of Sallie Mae common stock in order to be considered for our programs. In addition, the Board has agreed to review cases on an individual basis where a prospective participant believes that even this limited requirement will produce a hardship.

*

Senator PELL. Our next witness is J. Wilmer Mirandon, president, State Higher Education Assistance Corp. of New York.

STATEMENT OF J. WILMER MIRANDON, PRESIDENT, STATE HIGHER EDUCATION ASSISTANCE CORPORATION OF NEW YORK

MR. MIRANDON. My name is J. Wilmer Mirandon. I am president, not only of the New York Higher Education Assistance Corp., but of a new packaging concept for all student aid which will be known as New York Higher Education Services Corp. This will be effective July 1. We will then have the ability to lump grants and loans in what would be an appropriate assortment.

I am a lawyer, former banker, former senior vice president for one of the money center banks who entered this field only 9 months ago. I hope I have some objective views.

I am appreciative of this opportunity to be here. I expected merely to be an observer.

I would like to hit upon a couple of points, mainly what I call the underestimated value of the guaranteed student loan program. In New York where we deal with one out of every five of these student loans nationally—20 percent of the student borrowers have borrowed through our organization—we find that the average loan of \$1,252 substantially covers the expenses of the student as opposed to the average grant of \$450. Yet, loans in the State of New York cost the State \$5 million per annum as opposed to \$130 million in grants.

Loans permit students the dignity of virtually paying their own way and a certain freedom of choice in selecting a school.

I think that many banks are unaware of the nature of the program from the standpoint that it offers a guaranteed investment in the youth market. There are not writeoffs in this program as opposed to writeoffs now approaching 2.5 percent delinquency in consumer lending today.

With an interest yield of 10 percent, including the special allowance, the current average portfolio in New York—

Senator PELL. Excuse me.

What did you say the delinquency rate was?

MR. MIRANDON. The delinquency rate in New York is about 6.1 percent. This is on all matured paper since the inception of the program which began in 1958 in New York.

Senator PELL. Why are your figures so different than those of the national group?

MR. MIRANDON. Direct, frequent contact with students. I would like to distinguish the fact that there are really two programs in one: the Federal nonagency program and the agency State programs. I feel our State agency is dedicated to the reduction of defaults because we have an incentive to do so.

I think this uniqueness where we, in agency States, are dealing with about 32 percent more borrowers than in nonagency States, might have a significant impact upon these hearings. We do not have as poor a default ratio and yet we do not receive an equality of Federal benefits as in the agency States.

We also have a unique processing relationship with banks in New York; a direct middleman relationship between lenders and Government. This allows us to take earlier action on delinquencies.

We have guaranteed \$1.3 billion in loans in New York; \$470 million of the \$1.3 billion has been repaid, leaving about \$800 million outstanding, approximately half of which has not matured; that is, students who are still in school.

I think it is interesting to note that each loan has cost the State only \$67 since the program's inception. That includes all administrative costs, all default losses by the State of New York, including the 20 percent factor, and all State interest subsidies. This does not take into consideration the roughly \$40 million of interest subsidies now brought into the State annually which generate tax revenue.

Defaults require attention, and we know this, but I feel the students have been maligned. I think it is the system that is at fault and not the students. Ninety-four percent of matured paper that should be in repayment is in some form of repayment in New York. Most students pay on time—in fact, there are more students who repay early than those who are delinquent.

Since March, we have worked with our banks in a real cleanup effort to identify loans that had matured but were not in repayment. The banks in New York are particularly amenable to this program and have been since the very beginning.

We found that by bringing in these loans in rather massive proportions and working on them ourselves, we have averted—that is, returned these claims back to the banks at a 60 percent rate. These were supposedly bad loans, but by merely talking to the youngster we found that he or she truly did not understand the nature of the obligation.

On the claims we in fact purchased, we are now collecting about \$200,000 more a month than ever before, which is nearly twice as much as we collected in the past.

[The following information was subsequently supplied for the record:]

QUESTIONABLE LOANS AND DEFAULT RATES

It is interesting to note that since our housecleaning of questionable loans started, the rate of default claims purchased by our Corporation has dropped 19%, from 7,400 in 1973 to 6,010 this year, the dollar amount has declined 12% from \$12,394,991 in 1973 to \$10,854,713 in 1974. We believe a reanalysis of the dire projections of future defaults is required in the light of these figures.

Mr. MIRANDON. It is a high-risk program of inexperienced borrowers, but we find that the student when contacted frequently over the course of the loan, as Mr. Fox just pointed out, is perfectly willing to repay as long as he can familiarize himself with the obligation. In a way the loan program is an educational experience in itself for these students.

Our new course of action in New York, I think, is interesting because last winter, with McKinsey & Co. helping, we did a real deep analysis of this program. It is unquestionably clear that student loans require a direct, frequent, continuous relationship with each student borrower from the time a loan is originated. We are doing this with questionnaires from which we received a 64-percent response. We also do it with exit interviews; an 82-percent response was received from people who are now contacting their bank through postcards and other documents. Also there are statements of responsibility in which the obligation is explained right on the back of the note which the

student must attest to. Finally we maintain frequent contact by means of direct interest billing. Here we have taken on the paperwork obligation, the headache of the banks, as we do this processing at the Assistance Corp.

New York recently enacted a 4-percent subsidized loan for families with adjusted gross incomes between \$15,000 and \$30,000. Here we are again doing direct interest billing for the banks.

Additionally, to ease the lender's reconciliation burden, we are entering into what is known as single debit posting. Here we will operate very much like a mortgage loan processing center and, in fact, keep one set of books, post these books at one time in one place, and allow the bank, of course, to control this with a monthly, composite reconciliation.

Senator PELL. I am going to have to leave shortly. I have to receive the Portuguese Foreign Minister.

Mr. MIRANDON. I am sorry. I regret that.

I will be happy to send this to you in the form of a written letter.

Senator PELL. Would you? .

I feel very badly about this. But thank you very much indeed.

I am impressed with the experience you have in New York.

I have one question.

Am I correct in saying the reason you have a lower default rate than the national average is because you are a little more careful in the screening to whom you extend the loans?

Mr. MIRANDON. I think it is partially that, for I feel the banks in the upstate areas of New York certainly have screened these loans very carefully. The urban center banks have a more difficult time in doing that.

We feel that direct, frequent, continual contact with the student is the thing, the awareness of the obligation, is the thing that is so essential.

[The following information subsequently supplied for the record follows:]

We are working more closely with the financial aid administrators of the schools, particularly as we move into our new, comprehensive student aid services Corporation. The school financial aid administrator is extremely important, possibly the most crucial element in the system, for it is here that reasonableness, good judgment and fairness in selecting an appropriate assortment of financial assistance for each student's "aid voucher" comes to bear. More should be done to elevate this job and define its importance.

In summation, we in New York believe the loan program is a sensible and low cost delivery mechanism for student aid if it is reasonably used with an intelligent combination of other available assistance and if it is effectively managed.

Thank you, so much, for this opportunity.

Senator PELL. I share your high regard for McKinsey & Co. They could not make me more efficient, but they tried to make my office more efficient.

Thank you very much indeed.

[The prepared statement of Mr. Mirandon plus a supplemental communication follow:]



New York Higher Education Assistance Corporation

50 Wolf Road Albany, New York 12205

Tel. (518) 457-3457

Officers

Thomas P. Deon, Chairman
 Wilmot R. Craig, Vice Chairman
 William G. Morton, Treasurer
 Russell N. Service, Secretary

President

J. Wilmer Mirandon

Directors

Dr. Judith Cahn
 Associate Chairman of
 Executive Committee
 Willard C. Ales
 Dr. Ernest L. Boyer
 Wilmot R. Craig
 Thomas P. Deon
 Walter A. Kassenbrock
 Norma Kershaw
 Rev. Laurence J. McGinley, S.J.
 David F. Merrill
 William G. Morton
 Ewald B. Nyquist
 Russell N. Service

The Honorable Claiborne Pell
 Chairman
 Sub-Committee on Education
 Senate Office Building
 Washington, D. C.

September 23, 1974

Dear Senator Pell:

Thank you for the privilege of appearing before your Sub-
 committee on Education last Wednesday.

My rough notes have been given some formality and are enclosed.
 Time did not permit discussion of a number of topics in this
 written testimony which should be of interest, including a
 reduction of our defaults as compared to 1973.

It was difficult to be as enthusiastic about the future of student
 loans when I accepted the Presidency of the New York Higher
 Education Assistance Corporation nine months ago. Now after
 analyzing the program, determining reasonable objectives and
 changing the system in New York, I am solidly behind student
 loans as an integral part of the total higher education aid
 package.

Please call upon me for further information. I would be honored
 and delighted to be of assistance.

Sincerely,

J. Wilmer Mirandon
 President

Executive Staff

R. Kenneth Ecker
 Vice President - Control
 Harold M. Gotthorn
 Vice President - Operations
 Elwood G. Farber
 Director - Planning
 and Development
 Herbert G. Drew
 Director - Personnel
 and General Services
 Elwood D. Hallister, Jr.
 Assistant to the President
 Ruth E. Jopp
 Executive Secretary

JWM/js
 Enclosure



Statement
by
J. Wilmer Mirandon

President
of
New York Higher Education Assistance Corporation

Before the
Sub-Committee on Education
United States Senate

Wednesday, September 18, 1974

Mr. Chairman; Members of the Committee,

My name is J. Wilmer Brundage. I am President of the New York Higher Education Assistance Corporation and the recently enacted New York Higher Education Services Corporation. The former, originated in 1957, represents one out of every five student borrowers in the Guaranteed Student Loan Program nationally. The latter - a Corporation to be in operation July 1, 1975 - is a concept for packaging an effective assortment of student aid, (grants and loans), on "one menu". I am a lawyer and former banker who entered this field only nine months ago. Today, rather than merely observing the committee's activities, I find myself in the enviable position of suddenly offering you a summary of my thoughts from some rough general notes.

Please allow me to discuss three basic points with you:

One - The underestimated value of the Guaranteed Student Loan Program as practiced in "agency states".

Two - Defaults.

Three - Our new course of action in New York.

THE LOAN PROGRAM'S UNDERESTIMATED VALUE

Obviously, this program that virtually pays its own way if managed effectively can assist the average taxpayer whose funding of higher education is nearing a practical maximum.

Loans substantially aid the New York student in paying the costs involved; an average loan being \$1,252 versus an average grant of \$450. Yet loans cost the State about \$5 million a year as opposed to \$130 million for grants.

Grants must be the large foundation of any student assistance program but the cost of such monetary awards are expected to be considerably greater as time goes on. Therefore, loans should play a part in balancing this aid.

Loans permit students to maintain the dignity of earning their post-secondary education as well as the freedom and discretion of choosing a school they desire.

Moreover, the program allows banks a guaranteed investment in the youth

marked with no write-offs (which are now approaching 2.5% in consumer lending) and with an interest yield of 10% including the present special allowance. The current New York average portfolio yields 8.7%, without consideration of the 2.5% safety factor.

Therefore, we in New York are convinced that the loan program offers low cost, substantial support for students and schools. The program makes good sense if systematically managed by schools, lenders and Government, together aware of one another's needs, and if reasonably used.

Before embarking on my second point, defaults, let me emphasize that agency states like New York are unique. Not only do we enjoy lower default ratios and a production of 32% more loans than those states entirely dependent on the Federal program, but we do not receive Federal benefits equivalent to the non-agency states, although we are in the same program. We strongly urge that the recommendations of the National Council of Higher Education Loan Programs be adopted to insure equitable treatment and eliminate unnecessary complexities.

In New York, which also has a unique, direct processing relationship with its lenders, we have guaranteed \$1,300,000,000 in loans to 670,000 students. That New York lenders are highly committed to the program is attested by the fact that twice as many dollars have been loaned to more than twice as many students than in any other state. The comparison is made only since the Federal program started in 1966. So far this year, even in a tight money market, New York banks have increased their loans from 59,783 to 65,137 representing an increase in dollars from \$76,761,640 to \$89,569,194.

\$470 million of the \$1.3 billion loaned in New York has been repaid, leaving about \$800 million outstanding, approximately half of which is owed by students still in school and therefore not yet in repayment.

It is interesting to note that each loan has cost the State only \$67 since the program's inception. This includes all administrative costs, all default

losses and all State interest subsidies. It does not take into consideration the \$40 million per year brought into New York in interest subsidies, which generate substantial Federal tax revenue.

DEFAULTS

Although defaults require intensive action, I feel the students have been maligned. In New York, 94% of the matured paper that should be in repayment, is in some form of repayment, either to the lender or to our Corporation. More students are early repayers of their loans in New York than those delinquent.

Since March we have worked with banks in a "clean up" of loans that appeared to have matured but which were not in repayment. Our Corporation began to contact these borrowers and to avert - return to lenders - over 60% of these supposedly bad loans. These loans, now in repayment, represent what might have been \$30 million in losses this year. Our own collections on claims we in fact purchased from banks doubled from about \$200,000 per month to \$400,000 or roughly \$4 million per year. In this high risk program of inexperienced borrowers we have found most students willing to repay but not completely familiar with their obligation. Without doubt a loan is an educational experience in itself.

It is interesting to note that since our housecleaning of questionable loans started, the rate of default claims purchased by our Corporation has dropped 19%, from 7,400 in 1973 to 6,010 this year, the dollar amount has declined 12% from \$12,394,991 in 1973 to \$10,854,713 in 1974. We believe a reanalysis of the dire projections of future defaults is required in the light of these figures.

NEW YORK'S NEW COURSE OF ACTION

After thorough analysis last winter with the help of McKinsey and Company, it is unquestionably clear that student loans require a direct, frequent and continuous relationship with each student borrower from the time the loan is issued. The success of "Sallie Mae" the Student Loan Marketing Association, an intelligent

means of creating liquidity for lenders while generating more loans, is dependant upon this fact.

We are maintaining direct contact with students by means of questionnaires, exit interviews, Statements of Responsibility and direct interest billing. Our entire computer system on July 1st was converted to a student oriented system on a daily update basis.

To ease the lender's major billing burden on non-interest benefit loans and on the recently introduced 4% State subsidized loans for New York families with adjusted gross incomes between \$15,000 and \$30,000, we are now billing and collecting interest directly from students. This may serve as a pilot project to determine if Federal interest subsidies can be gradually reduced. A 3% interest payment responsibility carried by students while in school should create a psychological disincentive to enlarge their loan burden while continually reminding them of their obligation and allowing us to track their status. However, there is a terribly important caveat that cannot be ignored; it is that a system such as our direct billing method must be in existence beforehand to prevent banks, already inundated with paper work, from dropping out of the program. Currently we have approximately \$37 million in Federally unsubsidized loans outstanding in New York. This figure is growing.

To further ease the complexities of interest billing between banks and Government, we have embarked upon an accounting program of "single debit posting" wherein we will maintain one set of books and update them at one time in one place; a centralized rapid processing service for each bank wherein we can also service those loans which have been warehoused or purchased by organizations such as Sallie Mae.

We are working more closely with the financial aid administrators of the schools, particularly as we move into our new, comprehensive student aid services Corporation. The school financial aid administrator is extremely important,

BEST COPY AVAILABLE

62

-5-

possibly the most crucial element in the system, for it is here that reasonableness, good judgement and fairness in selecting an appropriate assortment of financial assistance for each student's "aid voucher" comes to bear. More should be done to elevate this job and define its importance.

In summation, we in New York believe the loan program is a sensible and low cost delivery mechanism for student aid if it is reasonably used with an intelligent combination of other available assistance and if it is effectively managed.

Thank you, so much, for this opportunity.

68
70



New York Higher Education Assistance Corporation

50 Wolf Road Albany, New York 12205

Tel. (518) 457-3457

Officers

Thomas P. Dann, Chairman
William R. Craig, Vice Chairman
William G. Morton, Treasurer
Russell H. Service, Secretary

President

J. William Merenda

Directors

Dr. Judith Cahn
Assembly Chairman of
Education Committee
William C. Allen
Dr. Ernest L. Boyer
William R. Craig
Thomas P. Dann
Walter A. Kasperowicz
Norman Kordas
New Laurence J. McGinty, S.J.
David P. Moran
William G. Morton
Russell H. Service
Russell H. Service

The Honorable Claiborne Pell
United States Senate
Senate Office Building
Washington, D. C.

November 20, 1974

Dear Senator Pell:

Recently the "American Banker" featured an article (attached) which outlined specific recommendations to you by the American Banking Association concerning control of defaults within the Guaranteed Student Loan Program.

Our experience in New York State suggests that the ABA's points are well taken. As a State Guarantee Agency, we have resisted pressures to permit schools to function as lenders. Moreover, we have exercised judgement with respect to repayment schedules and we have mounted effective collection efforts.

As mentioned in my testimony before your committee during September, we are the largest State Guarantee Agency in the nation, administering one out of five of the guaranteed student loans outstanding, at a current yearly administrative cost of less than four million dollars. We believe our observations and policies may be useful to you by reason that our present portfolio approaches 1.4 billion dollars in loans with about \$780 million still outstanding.

Default rates represent a comparative index. A universal, standard method of calculation should be established for consistency and comparison between state and federal operations. The rates presented in the attached tabulation are computed on a cumulative basis - defaults versus matured paper. These components which act to influence the default rate are portrayed in Exhibit B. It is evident that not only are purchased default claims on the decline, but that the relatively stable amount of matured paper substantiates the expected plateau in the New York default rate for the foreseeable future. Since these projections are based on regression analysis, the impact of a drastic change in the economy has not been considered.

Executive Staff

B. Kenneth Bates
Vice President - Control
Harold M. Gullberg
Vice President - Operations

Sheldon G. Parker
Director - Planning
and Development

Harbert G. Drew
Director - Personnel
and General Services

Sheldon D. Hollister, Jr.
Assistant to the President

Ruth E. Jago
Executive Secretary



Hon. Claiborne Pell

-2-

November 20, 1974

Exhibit C includes a table of our default rates by type of lender cumulatively as of March 31, 1974, as well as a comparison of the default rates by number of borrowers for the last three years. Our program does not permit schools to serve as lenders, however the default rates by type of school the borrower attended have been included for your reference. Additionally, Exhibit D indicates an interesting comparison of drop-out rates between borrowers and defaulters.

Defaults are collectible if judiciously followed and reasonable repayment terms are offered. We have developed extensive collection efforts related to purchased defaulted notes and we will collect between three and four million dollars during 1974-75. That amount may double by the end of fiscal 1975-76.

We have encouraged lenders to practice due diligence in their own collection efforts but to use our services by sending potential defaults to us as rapidly as their delinquency can be identified. Our pre-default aversion effort - tracing these borrowers for lenders - has led to a surprising 60% being returned to lenders with the student now ready and willing to repay. As a result, we seem to have stemmed the tide of increasing defaults and, in the face of larger number of loans, actually reduced default claims expenditures by roughly 10% versus a year ago.

There seem to be a few simple policies among others, which can effectively counteract defaults:

1. Financial aid should be analyzed and packaged so that students may exhaust all grant and work-study assistance before resorting to loans.
2. Lending should be limited to established lending institutions familiar with credit standards.
3. Lenders should be supported and assisted by State Guarantee agencies equipped to service potential problem loans in a prompt and expert fashion.
4. Schools should be required (and assisted by state agencies) to verify student status on a regular basis by prompt submission of a student status verification report and exception reports.
5. Direct, frequent contact with student borrowers should be a constant goal of the State agency by means of:
 - a. Regular student mailings (questionnaires) to obtain up-to-date information on school status as well as current address.
 - b. Increased use of caution letters to students on the verge of default.
 - c. Closer personal contact with student defaulters and the schools involved.
 - d. Initiation by the State agency of a centralized single debit posting system for all of its lenders which will marshal all facts accurately and will automatically identify and send letters to delinquent borrowers before defaults occur.

Hon. Claiborne Pell

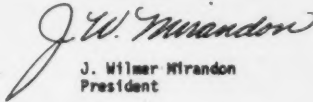
-3-

November 20, 1974

- e. Timely mailings of student "exit interview" reminders pointing out the steps all students should take with banks immediately upon graduation.
- f. A Statement of Responsibility pointing out the seriousness of the obligation, repayment terms, etc. and tied into the loan note so that students comprehend their obligation at the initiation of the loan.
- 6. Collection, and in some cases litigation, of defaulted notes must be promptly pursued to protect the integrity of the program and to assure new loans for the next tier of students.

I hope the above comments may be of use to you. We are dedicated to improving this program which has afforded a higher education opportunity to over 690,000 New Yorkers and which can virtually pay for itself if well managed. Again let me say how much I appreciated being permitted to appear before your committee.

Sincerely,



J. Wilmer Mirandon
President

JWM/js

Enclosure

AMERICAN BANKER

October 7, 1974

in the annual public finance

ABA Scores Student Loan Default Rate

By LYNN CONOVER

WASHINGTON. — The American Bankers Association has told Congress that the current default rate on guaranteed student loans has reached an intolerable level. It also made several recommendations which it said would aid in the reduction of student loan defaults and delinquencies.

"We feel that it is essential that the Congress and the financial community get reliable figures on defaults and delinquencies, not just as to the volume but also by class of lender," the banking industry group said. The ABA noted that projected default figures for the next academic year ranged from 11.5% to 21.3%.

It made the comments in a letter to

(Continued on page 8)

Loan Default Rate

(Continued from page 1)

Sen. Clairborne Pell, D., R. I., chairman of the subcommittee on education of the Senate Labor and Public Welfare Committee. Mr. Pell had asked for comment on the default problem.

The ABA letter noted that statistics from the Office of Education show the greatest percentage of delinquency in student loan repayments occurred when schools served as lenders—31.83% for vocational schools and 34.41% for institutions of higher education.

"If these figures are valid," the bank trade group said, "then a sharp curtailment of school lending activities seems a must." It suggested that such a curtailment be accomplished through legislation.

The ABA suggested several steps to reduce student loan delinquencies and defaults, including:

- Allowing the Office of Education to use the Social Security Administration to help in tracing students who default and cannot otherwise be located. "This recommendation has caused us a great deal of concern because of its potential abuse to an individual's right of privacy," the ABA letter said, adding that this information should not be made available to lenders.

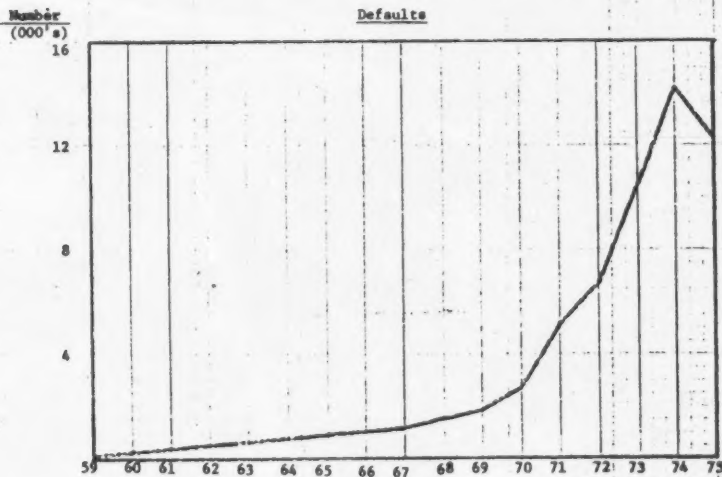
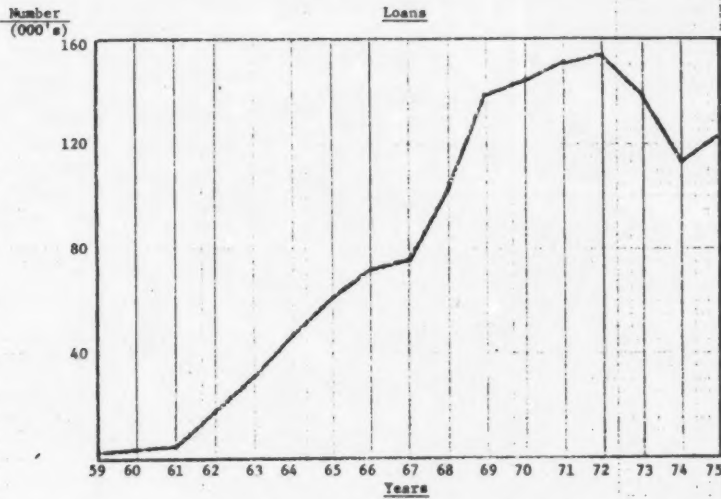
- Allowing students the option of graduated repayment of their loans.

- Requiring schools to notify lenders when a student is graduated or withdraws, as well to provide the student's last known address of record.

- Utilizing Federal government agencies to attempt to collect from a student unwilling to repay a loan. The ABA letter said that "a determined and well publicized effort in this direction could produce dramatic reduction in the rate of default."

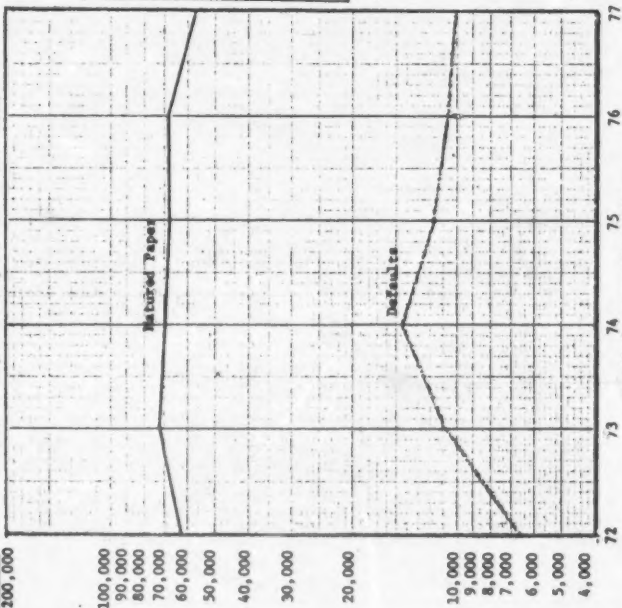
NEW YORK HIGHER EDUCATION SERVICES CORPORATION

Exhibit A.



BEST COPY AVAILABLE

Defaults Vs. Matured Paper
Fiscal Comparisons by Number of Borrowers



Index Comparisons
Percentage Increase in Number of Borrowers
Over 1971-72

Fiscal Year	Defaults		Matured Paper	
	No.	Percentage Increase	No.	Percentage Increase
1976-77	10,000	150%	56,900	91%
1975-76	10,500	157%	68,008	109%
1974-75	11,656	174%	67,782	109%
1973-74	14,117	211%	69,733	112%
1972-73	10,699	160%	71,114	114%
1971-72	6,686	100%	62,436	100%

NEW YORK HIGHWAY EMULATION SERVICES CORPORATION

Exhibit C.

Default Rates of Student Borrowers in New York State

Default Rates by Type of Lender (Cumulative - 1958-3/74)

	Number			Dollars (000's)		
	Defaults	Matured Paper	Default Rate	Defaults	Matured Paper	Default Rate
Commercial Banks	21,230	254,078	8.4%	\$26,423	\$462,735	5.7%
Savings Banks	15,181	152,160	10.0%	19,295	284,860	6.8%
Sav. & Loan Assn.	2,001	30,637	6.5%	2,887	52,984	5.4%
Credit Unions & Pension Funds	32	1,236	2.6%	66	1,870	3.5%
TOTAL	38,444	438,111	8.7%	\$48,671	\$802,449	6.1%

Default Rates by Type of Lender (Fiscal Comparisons)

	Cumulative Default Rates By Number of Borrowers		
	1971-72	1972-73	1973-74
Commercial Banks	4.8%	7.4%	8.4%
Savings Banks	6.8%	9.2%	10.0%
Sav. & Loan Assn.	4.6%	5.9%	6.5%
Credit Unions & Pension Funds	1.9%	2.4%	2.6%
TOTAL	5.4%	7.9%	8.7%

Default Rates by Type of School (Cumulative - 1958-3/74)

Type of School	Number			Type of School	Number		
	Defaults	Matured Paper	Default Rate		Defaults	Matured Paper	Default Rate
<u>New York State</u>				<u>Out of State</u>	6,918	85,744	8.1%
H. Ed. 4Yr.				<u>Foreign</u>	157	1,424	11.0%
City				<u>Vocational:</u>			
State	4,071	75,113	5.4%	Beauty	3,456	10,074	34.3%
Private	9,889	140,258	7.1%	Nursing	154	3,405	4.5%
H. Ed. 2Yr.				Business	3,547	30,454	11.6%
City	1,234	5,323	23.2%	Trade	2,894	14,216	20.4%
State	3,568	50,277	7.1%	Out/St. Voc.	224	2,214	10.1%
Private	384	5,612	6.8%				

NEW YORK HIGHER EDUCATION ASSISTANCE CORPORATION

Exhibit D.

Left School Ratios
By Type of School

Comparison of Cumulative Borrowers & Defaulters by Type of School

Type of School	All Borrowers		Defaulters	
	Graduated	Withdrew	Graduated	Withdrew
<u>Higher Ed. - In State</u>				
Four Year:				
City U.	55%	45%	38%	62%
State U.	66%	34%	33%	67%
Private	65%	35%	31%	69%
Two Year:				
City U.	33%	67%	21%	79%
State U.	35%	65%	11%	89%
Private	49%	51%	20%	80%
<u>Higher Ed. - Out of State</u>	62%	38%	32%	68%
<u>Higher Ed. - Foreign</u>	57%	43%	38%	62%
<u>Vocational:</u>				
Beauty	75%	25%	54%	46%
Nursing	78%	22%	46%	54%
Business	66%	34%	41%	59%
Trade	65%	35%	35%	65%
Out/St. Voc.	55%	45%	25%	75%
TOTAL	60%	40%	32%	68%

Senator PELL. The hearing is adjourned until 10 o'clock tomorrow.
[Whereupon, at 12:50 p.m., the subcommittee adjourned to
reconvene at 10 a.m., Thursday, Sept. 19, 1974.]

EXAMINATION OF THE GUARANTEED STUDENT LOAN PROGRAM, 1974

THURSDAY, SEPTEMBER 19, 1974

U.S. SENATE,
SUBCOMMITTEE ON EDUCATION OF THE
COMMITTEE ON LABOR AND PUBLIC WELFARE,
Washington, D.C.

The subcommittee met, pursuant to order, at 10:05 a.m., in room 4232, Dirksen Senate Office Building, the Honorable Claiborne Pell, subcommittee chairman, presiding.

Present: Senator Pell.

Committee staff present: Stephen J. Wexler, counsel; and Roy H. Millenson, minority professional staff.

Senator PELL. The subcommittee will come to order.

Today we continue our discussion of the guaranteed student loan program and the default rate.

Yesterday's hearing, somewhat truncated by floor activity in the Senate Chamber, was most helpful in developing necessary statistics on which we can base further decisions on the guaranteed student loan program.

There is some argument in connection with these statistics. They indicate either 18 percent or 24 percent—a low of 18, a high of 24—proposed rate of default.

The question is which way the trend is going.

The administration's view is the trend will go down.

The statistics until now show it is going the other way, as I understand it, and this is the conclusion which remains to be decided.

Young people are now in a predicament. Sometimes, through unscrupulous salesmen, they sign up for a course, their credit is laid on the line. The policy of the Federal Government, in my view, should be to tighten up more and more on making sure these young people not only get the education contracted for but that they pay these loans back; that they should be made aware of the facts; that failure to repay will affect their credit rating, they will not be able to buy a car when they still owe money to the Government.

However, when the school has gone out of business through no fault of the youngster, then I think some means must be taken to protect that youngster.

Our first witness today is Senator John Tunney of California, who has introduced a most creative piece of legislation which would protect all those youngsters who have taken out guaranteed student loans but who were attending schools which went out of business.

At this time I order printed in the record the bill introduced by Senator Tunney.

[The text of S. 3807 follows:]

(73)

93d CONGRESS
2d Session**S. 3807**

IN THE SENATE OF THE UNITED STATES

JULY 25, 1974

MR. TUNNEY introduced the following bill; which was read twice and referred
to the Committee on Labor and Public Welfare

A BILL

To protect students receiving Federal financial assistance against
losses resulting from the closing of certain private educational
institutions.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act be cited as the "Student Loan Protection Act
4 of 1974".

DEFINITIONS

5
6 SEC. 2. For purposes of this Act—

7 (1) The term "Federal student loan" means a loan
8 made by any department or agency of the United States
9 to an individual to assist that individual to attend an
10 educational institution.

11

1 (2) The term "federally insured student loan"
2 means a loan which is made by any person or by any
3 department or agency of a State or local government to
4 assist that individual to attend an educational institution
5 and the repayment of which is insured or guaranteed, in
6 whole or in part, by a department or agency of the
7 United States.

8 (3) The term "veterans educational allowance"
9 means subsistence allowance paid under chapter 31 of
10 title 38, United States Code, and educational assistance
11 allowance paid under chapters 34 and 35 of such title.

12 (4) The term "educational institution" means any
13 institution which furnishes education or training at the
14 secondary level or above, including vocational schools
15 and correspondence schools

16 (5) The term "new private educational institution"
17 means any educational institution which (A) is not an
18 agency of the United States, a State or political sub-
19 division thereof, the District of Columbia, the Common-
20 wealth of Puerto Rico, or a possession of the United
21 States, and is not owned and operated by one or more of
22 the foregoing, and (B) which has been in operation for
23 less than ten years.

24 (6) The term "academic period" means, with re-
25 spect to any new private educational institution, a

1 semester, trimester, quarter, or other period of time
2 during which education or training is offered by such
3 institution. In the case of a new private educational in-
4 stitution which does not offer education or training based
5 on an academic period within the meaning of the preced-
6 ing sentence, such term means, with respect to any
7 individual, that period which begins on the date on
8 which such individual first attends such institution dur-
9 ing an uncompleted course of study or training.

10 (7) The term "Secretary" means the Secretary of
11 Health, Education, and Welfare.

12 REQUIREMENT OF GUARANTEES BY NEW PRIVATE EDU-
13 CATIONAL INSTITUTIONS

14 SEC. 3. (a) On and after the effective date of this
15 section—

16 (1) no Federal student loan or federally insured
17 student loan may be made to an individual to assist
18 that individual to attend a new private educational
19 institution, and

20 (2) no veterans educational allowance may be
21 paid to an individual attending a new private educa-
22 tional institution,

23 unless the private educational institution has provided assur-
24 ances satisfactory to the Secretary (by the posting of a bond
25 or otherwise) that, in the event such institution ceases opera-

1 tions, it will make the payments required by subsection (b)
2 with respect to each individual then attending such institu-
3 tion with the assistance of a Federal student loan or a fed-
4 erally insured student loan or who is receiving a veterans
5 educational allowance.

6 (b) The amount to be paid with respect to an individual
7 under subsection (a) is an amount equal to the expenses paid
8 by such individual to enable him to attend such institution
9 during the academic period in which such institution ceases
10 operations, but such amount shall not exceed—

11 (1) in the case of an individual attending with the
12 assistance of a Federal student loan or federally insured
13 student loan, the portion of the loan attributable to such
14 academic period, or

15 (2) in the case of an individual receiving a veterans
16 educational allowance, the amount of such allowance
17 received which is attributable to such academic period.

18 (c) The payments required by this section shall be
19 made—

20 (1) with respect to an individual attending with
21 assistance of a Federal student loan or federally insured
22 student loan, to the lender as repayment of part or all
23 of such loan, except that if such loan has been repaid,
24 the payment shall be made to such individual, and

(2) with respect to an individual receiving a veterans educational allowance, to such individual.

3 PROTECTION AGAINST LOSSES NOT COVERED BY
4 GUARANTEES

5 SEC. 4. (a) In the case of an individual who—

(1) was attending a new private educational institution which ceased operations on or before the date of the enactment of this Act,

(2) is attending a new private educational institution which ceases operations after such date and before the effective date of section 3 with respect to such institution, or

(3) is attending a new private educational institution which has failed to give the assurances required by section 3 and which ceases operations after the effective date of that section with respect to such institution, but only if such individual is pursuing education or training which he commenced at such institution before such effective date.

20 the Secretary shall take the action required by subsection
21 (b).

22 (b) With respect to an individual described in sub-
23 section (a)—

(1) who was attending the institution with the assistance of a Federal student loan, the Secretary shall

6

1 cancel an amount of such loan equal to the amount
2 which would be payable under section 3 if that sec-
3 tion applied, except that if such loan has been repaid,
4 the Secretary shall pay such amount to such individual,

5 (2) who was attending such institution with the
6 assistance of a federally insured student loan, the Sec-
7 retary shall pay to the lender (as a repayment of part
8 or all of the loan) an amount equal to the amount
9 which would be payable under section 3 if that sec-
10 tion applied, or if the loan has been repaid, shall pay
11 such amount to the individual, and

12 (3) who was receiving a veterans educational
13 allowance, the Secretary shall pay to the individual the
14 amount which would be payable under section 3 if that
15 section applied.

16

REGULATIONS

17 SEC. 5. The Secretary, after consultation with the Ad-
18 ministrator of Veterans' Affairs, shall prescribe such regula-
19 tions as may be necessary to carry out the provisions of
20 this Act.

21

AUTHORIZATION OF APPROPRIATIONS

22 SEC. 6. There are authorized to be appropriated for
23 each fiscal year such sums as may be necessary to carry
24 out the provisions of this Act.

1 EFFECTIVE DATE

2 SEC. 7. This Act shall take effect on the date of its
3 enactment, except that the provisions of section 3 shall
4 take effect with respect to any new private educational
5 institution on the first day of the first academic period of
6 such institution which begins more than ninety days after
7 the date of the enactment of this Act.

Senator PELL. I now call on Senator Tunney, who has a marvelous sense of timing.

**STATEMENT OF HON. JOHN V. TUNNEY, A U.S. SENATOR FROM
THE STATE OF CALIFORNIA**

Senator TUNNEY. Thank you very much, Mr. Chairman.

I would hope that the good luck which enabled me to come in the hearing room with such perfect timing will also facilitate the passage of this legislation through the Senate.

I want to thank you very much for giving me this opportunity to testify before you today.

I am conscious of the fact that you and your subcommittee have done so much to promote educational quality in the country, and I consider it a distinct honor that you have given me this opportunity to present my views with respect to S. 3807, the Student Loan Protection Act of 1974.

Mr. Chairman, I recognize the time constraints of the committee and, therefore, I would like to have my statement included in the record as if read.

Senator PELL. With no objection, it will be included in its entirety following your testimony.

Senator TUNNEY. I would just like to highlight a few aspects of it.

Mr. Chairman, the problem is one which was brought to my attention because in my hometown in California, Riverside, a university came into being at the end of the 1960's that grew rapidly. It was a business college.

Unfortunately, this rapid growth was coupled with unscrupulous behavior on the part of those who were managing the institution in an academic sense and in a business sense, as well.

They led the students to believe that they offered educational opportunities which, in fact, did not exist.

They were able to become accredited through the Western College Association. As a result of that, the schools were able to accept students who were receiving federally insured student loans, and/or veterans educational benefits.

This particular institution went kaput.

When it was discovered that massive fraud was being practiced on the students as well as on the Federal Government—the students were not receiving the education they had anticipated, nor were they being prepared for jobs which the curriculum supposedly was intended to do.

Of extreme importance is the fact that the school was taking money from the Federal Government through these insured loans, and veterans benefits for courses that were not accredited by the Federal Government.

The school falsely represented the kind of program that was being presented. Many students suddenly found themselves, when the school closed, left high and dry. They suddenly found themselves not only without an education but owing substantial amounts of money to the Federal Government.

In this legislation, I would like to one, require bonds for new schools that hold themselves out as providing vocational education, thereby qualifying for Government loans to students.

Then, if the schools fold, they would use the money from this bond to pay the students for that portion of the education that was not completed.

I outline in my written statement specifically what we are talking about, and I will not go into it now.

Secondly, we ought to have a forgiveness provision for those institutions that have already folded. We are not talking about a great deal of money. We are talking about a relatively small amount of money as far as Federal expenditures go.

I think if the students have repaid those loans, they should be reimbursed for those payments. Although I would dare to say—and I do not have any statistical data to back this up—that there would be very few students who have repaid the loans.

The legislation also provides that there would be forgiveness in an instance where the institution folds during that period between the passage of this bill and the beginning of the school term.

That basically is what the bill is all about. I recognize that it covers a relatively small number of students, and I recognize that this committee is used to bills of cosmic proportions which deal with the entire student population.

But I think it really does give tremendous assistance to a group of students who need it the most. I think it would be an act of compassion for this committee, and for the Senate and for the Congress, to provide for these students who were so badly misled and who will suffer substantially as a result of these educational institutions closing down.

Senator PELL. I think the idea is an excellent one.

Do you have any idea how much this would cost the Federal Government as drafted now?

In other words, would this cover only the proprietary private institutions?

As I understand, the Federal Government would pay under the grandfather clause, but if you have no grandfather clause, it would cost the Federal Government zero, would it not?

Senator TUNNEY. There are probably two major schools that close every year. We perhaps are talking about \$1 million per institution. We therefore are talking about somewhere between maybe \$2 million and \$3 million a year.

On grandfathering, it was sought to put a time limit on it, say go back 5 years, rather than go all the way back. This would not be appropriate as far as I am concerned.

I do think, however, that some grandfathering is needed because I think there are a lot of students who have been very badly hurt.

I, unfortunately, cannot speak with as much authority for the schools outside of California. I am not as knowledgeable as I am about the problems that exist in California schools, particularly the school that collapsed and went into bankruptcy in Riverside.

I did have a chance to meet a number of students, and my staff has met with tens of students, and I have received letters from several hundred of them. And I know the kind of suffering they have experienced.

The funny thing about this is that these are the kinds of individuals we would want to help in our society. They are the young men and women who have not received a university education, who went to

work, many of them, after high school, and are trying to better themselves.

They go to one of these vocational schools, usually at night, to try to better themselves, and then they get themselves into a position where they are owing substantial amounts of money.

Senator PELL. I would agree.

If the retroactive feature of it was not approved, if we would just work from now on, it would cost the Government nothing, I believe.

Would you agree with that statement?

Senator TUNNEY. That is correct.

Senator PELL. I see the necessity for some grandfathering. This is a question of political judgment and a question of dollars and cents in the budget.

I certainly think, as a minimum, we ought to incorporate the idea of this sort as maybe in the form of an amendment, as the Tunney amendment, to the higher education bill.

I think the concept is very good, and certainly as one member of the subcommittee, I look forward to supporting the concept for the future.

As far as the retroactivity goes, I would have to consider how that would work.

[The prepared statement of Senator Tunney follows:]

PREPARED STATEMENT OF HON. JOHN V. TUNNEY, A U.S. SENATOR
FROM THE STATE OF CALIFORNIA

Senator TUNNEY. Mr. Chairman, I appreciate this opportunity to appear before your committee to testify on S. 3807, the "Student Loan Protection Act of 1974."

I am particularly interested in the area of student assistance as it relates to vocational and proprietary institutions. The default rate on student loans continues to increase. In part, this is because of deadbeat students who intentionally ignore their repayment obligations. In many instances it is the fault of the educational institutions which themselves defaulted on their obligation to train and instruct.

In California, for example, two vocational institutions were forced to close at midterm. Thousands of students were stranded, with no education and crushing loan repayment obligations.

Riverside University (not to be confused with the University of California at Riverside) became a non-profit, 4-year institution in the fall of 1967. The university was an outgrowth of Riverside Business College which remained a part of the college. It received a high priority rating for grants from the California Council on Higher Education and was accredited by the Western College Association as a business college. To all appearances, the university gave every indication of being a reputable institution.

In April 1970, however, four former students charged that the school made "false, deceptive, inaccurate and misleading advertisements regarding its program in shorthand court reporting." They filed suit in Riverside Superior Court for refunds and damages totaling \$135,000. The complaint alleged that each student "was wholly unable to receive any semblance of a proper education so as to qualify him as a court reporter."

In May 1971, Riverside University closed, 5 weeks before the end of the quarter, and filed for bankruptcy. At the time the school closed, tuition refunds were denied and approximately 1 thousand students were left owing on loans that averaged \$2,000 and totaled \$2 million.

Shortly after the university closed, my office was inundated with letters from its students. Many had obtained federally-insured loans or veterans' education allowances and sought my assistance in obtaining Federal loan forgiveness. The response I received from the Office of Education, while possibly legally correct, was wholly unhelpful and unsympathetic. According to the Office of Education, "There is no provision in the Federal insured student loan program to absolve a student/borrower of his obligation to repay in the rare instance where he chooses to invest the proceeds of his loan in a school which fails to perform on its enrollment contract to provide the education paid for."

Those students who had received veterans' education allowance were denied further benefits and asked by the Veterans' Administration to return the money previously allocated to them for the purpose of attending Riverside University.

According to numerous press accounts, the university allegedly used false advertising, dishonest counseling of prospective students and deceitful administrative procedures in regard to VA benefits and federally insured student loans. Nevertheless, students were still required to repay their heavy loan obligations.

One student wrote me as follows:

When I enrolled in the Riverside University Law School, I was informed by the Dean of Admissions and his VA clerk that law school students were eligible for VA benefits. On this assurance, I enrolled in the law school and signed papers prepared by the school for a federally insured loan. Only sometime after enrollment, I learned I was falsely informed, deliberately and maliciously, because law school students were not approved for VA entitlements nor was the law school an eligible institution for federally insured loans.

This student had a loan balance due of \$1,400.

Another received a notice from the VA demanding repayment of \$4,308.24. He was allegedly misled into signing fraudulent papers.

One other student wrote:

I went to school (Riverside University) for about 2 weeks, and then I had to drop out because of problems at home. I was going to school at night, working during the day. When the problem arose, I had to do something. It was either quitting my job or school. So I quit school only after going 2 weeks. Now, 3 years later, I received a statement from the United California Bank in Pomona saying that I owe them about \$1,200.

As a final example, a letter from a student to the Veterans' Administration reads:

The way I see it, I have relied on these monthly payments from the VA, especially after you (VA), with full knowledge received my letters indicating that I enrolled in the law program back in December. Now you send me a letter saying the school made an erroneous certification and by my submitting my certificate to the University, I am supposed to pay back all of my legally entitled earned benefits for serving my country in the Armed Forces.

This student was dunned \$1,680.

The West Coast Trade School illustrates another, more recent example of a school closing midterm. West Coast Trade School was a group of five proprietary vocational schools in Los Angeles. The school was the lender, all courses were paid for in full and in advance. The

paper was immediately sold to outside financial institutions. When the school's bid for accreditation was not approved, its license to issue Government loans was revoked. Approximately 1,000 students were caught with loans amounting to millions of dollars, outstanding, when the school folded mid-session.

Obviously, I do not mean to implicate every proprietary or vocational institution in existence. Clearly, however, even one such case as Riverside University or the West Coast Trade School is enough to warrant the legislation I have introduced and which this committee is considering today.

My bill will provide for the protection of students in federally insured student loan programs when the vocational or proprietary institutions abruptly close. It would also protect students receiving veterans' education allowances.

Under present circumstances, when an institution closes its doors, a student may lose not only an education but thousands of dollars in future earnings.

Four parties are involved when a student contracts for a federally insured student loan: The student, the loaning institution, the educational institution and the Federal Government. Wherein lies the responsibility for repayment of that loan should the institution cease operation?

Clearly, the initial responsibility lies with the student. He or she has contracted for the purpose of obtaining an education with the hope that upon its completion, he or she will be able to become employed and repay the loan.

The loaning institution accepts only a small responsibility for the administration and processing of the loan.

The Federal Government has undertaken the responsibility of guaranteeing repayment of the loan should the student fail to do so.

The educational institution has the responsibility of educating the student. But if it closes prematurely, the student is left holding the bag.

My bill presents a viable solution to this problem. It stipulates that no Federal student loans, no federally insured student loans, and no veterans' education allowances may be paid to a vocational or proprietary institution that has been in existence for less than 10 years unless that school has provided assurances—by posting a bond or otherwise—that, in the event the institution ceases operation, it will reimburse the student for the portion of the loan that would cover the education not received.

Let me illustrate this by an example. A student is attending a vocational business college, four quarters per school year. The school is bonded. Three quarters have been completed and the student is 5 weeks into his fourth quarter. The school is forced to close. Under my legislation, the student would be reimbursed by the institution for the portion of the loan which covers the fourth quarter. This would allow him to transfer to another school with sufficient funds to complete a full quarter. In most instances, if the school is accredited—and it must be to receive Federal loans and VA benefits—the units completed can be transferred to another institution, while the partially completed units are not transferrable.

S. 3807 is restricted to private vocational and other proprietary institutions because they are much more vulnerable to failure than

institutions supported by taxpayer money, that is, State-supported colleges and universities.

My bill also includes a provision which stipulates that only those institutions in existence for 10 years or less must be bonded. Thus, after a reasonable period of time, a new, private educational institution could prove itself to be a viable and reputable institution.

Another portion of my bill directs the Secretary of HEW to forgive the portion of loans defaulted because of midterm school closings that have occurred prior to enactment of this legislation. The forgiven portion would cover the education not received. If the loan has already been repaid, the Government would reimburse the student directly.

This latter section was included to provide relief for recent victims of midterm closings. Forgiveness, however, is not the ultimate answer. For the long term, we need a solution that provides protection for all parties involved with student assistance. Neither the student, the loaning institution, nor the Federal Government should be forced to clean up after an educational institution that has failed its responsibility to educate.

Over the years, the Federal Government has been held responsible for over 116,000 defaulted student loans, a liability which has amounted to \$110.5 million of the taxpayers' money. In California alone, 9,923 loans were paid by the Government amounting to \$76.6 million. Obviously, only a small portion of these defaults were the result of institutional closings. However, one such instance is one too many. Thousands of students continue to be duped into attending new vocational and proprietary institutions by misleading, hard-sell advertising tactics. Unfortunately, in nearly all cases, the students who are victimized when these schools fail are those who can least afford it—students from low-income families and veterans.

Mr. Chairman, some type of protection is urgently needed. I hope this committee will give urgent and sympathetic consideration to the legislation I have presented today.

Thank you.

Senator TUNNEY. I want to thank you very much, Mr. Chairman.

Senator PELL. We will now receive for the record the statements of the senior Senator from Illinois, Mr. Percy, and Congressmen Bell and Pettis, both from the State of California.

PREPARED STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR
FROM THE STATE OF ILLINOIS

Senator PERCY. Mr. Chairman, I would like to commend the Education Subcommittee for holding oversight hearings on the Guaranteed Student Loan Program.

I have been aware of the accelerating default rate in the GSL Program for a number of years now, and I welcome the interest and expertise that this subcommittee is now focusing on this problem. In my own research into the GSL program, I found several specific difficulties that are in need of resolution.

One of the problems with which I am most concerned is the current set of restrictions on lenders. The law now prohibits any lender from executing a note whose first payment due date is earlier than 9 months from the date the student left school and whose schedule of payments

is less than 5 years. These restrictions were designed to protect student borrowers who might otherwise sign contracts 4 years in advance for repayment schedules advantageous to the lending institutions but potentially unmeetable by a young person straight out of school.

The restrictions seem to have the opposite effect, however. Students who wish to begin regular repayment immediately after graduation or who wish to pay off their notes in less than a 5-year period are unable to do so, and they must pay greater interest charges than if their loans were repayable in a shorter time. Graduating students who find themselves so restricted are evidently often incredulous and angry and react by defaulting on their loans.

I have also learned that many students default unnecessarily on GSL program loans in retaliation against the entire loan program because they feel they have been tricked by the "system." Guaranteed students loans are currently available up to a maximum of \$2,500 per year per student, but the total sum available throughout the post-secondary education period is only \$7,500 per student. A college student borrowing the maximum amount in each of his first 3 years will have used the \$7,500 total available before the completion of his education. If an unsuspecting student is not made fully aware of this possibility, he may find himself cut off from further borrowing and may be unable to finish his education.

Declarations of bankruptcy by student borrowers are a third major source of lost Federal funds in the GSL program. Most recent graduates have few assets and few, if any, debts aside from their student loans. To growing numbers of young people the temptation to dissolve this debt through bankruptcy is too great to resist. Since the inception of the GSL program in 1966, nearly 8,000 students have declared bankruptcy, forcing the Federal Government to reimburse lenders for nearly \$10 million. One of the most alarming aspects of this problem is the accelerating number of such claims; when I began my study last year, these figures were 3,000 students and \$4.5 million.

Undoubtedly some of these bankruptcy claims are legitimate. But the majority are not. Many students do not recognize the seriousness of declaring bankruptcy; they do not realize that "bilking" the Federal Government is in actuality "bilking" the taxpayers—their own families and friends. I know personally of instances in which student borrowers have declared bankruptcy not out of necessity but because of irresponsibility. In one case, a student who declared bankruptcy on a debt of \$1,625 went on to a high-paying job in the Illinois State University system; even though his student loan made possible his career, he has shirked his financial responsibility legally and with impunity. One student obtained \$6,000 from the Illinois GSL program plus thousands of dollars through other student aid programs. She declared bankruptcy, left Illinois and found high-paid employment elsewhere. Another borrower declared bankruptcy in order to dissolve his only debt—the \$5,675 owed for his Illinois guaranteed student loan. He was offered 1 to 2 years without repayment as well as temporary smaller payments; he refused. I find this financial and civic irresponsibility abhorrent, and I am certain my fellow taxpayers share my view.

As a result of my study of these problems with the guaranteed student loan program, I introduced S. 3572 to help provide the necessary solutions. I know that a much more comprehensive reform

of the GSL program than I have proposed is in order, and I fully support the subcommittee's intentions to undertake such reform. I do hope, however, that you will consider these specific problems I have outlined and that during your forthcoming efforts to improve the guaranteed student loan program you will consider the legislative changes I have proposed.

PREPARED STATEMENT OF HON. ALPHONZO BELL, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. BELL. Mr. Chairman, I want to commend the subcommittee for its attention to the growing incidence of abuses involving post-secondary education and the guaranteed student loan program.

As you know, this is a subject which has long been of particular concern to me, and I introduced a bill in the House last December, together with my distinguished California colleague, Mr. Pettis, which I hoped would provide at least a starting point for doing something about what I see as an unconscionable situation existing today with regards to the guaranteed student loan program.

I believe that Congress has an obligation to take immediate action to remedy this situation, which is particularly acute within the vocational and trade school industry.

An illustrative example of the sorts of abuses to which I am referring occurred in my own city of Los Angeles: The West Coast Trade Schools, a corporate entity maintaining five proprietary vocational schools located in and around Los Angeles, closed its doors on 2 days' notice in May 1973, leaving at least \$6 million of potentially worthless loan paper in the hands of unsuspecting financial institutions, primarily employee credit unions.

EDCO, Inc., a Los Angeles firm which is now servicing West Coast's loans for six of these credit unions, has informed my office that roughly 80 percent of the alleged borrowers either cannot be located or have refused to pay their loans on the grounds that they never received the education they were promised.

An EDCO representative told my office that he has not found "any students who are satisfied. The only students who are paying—and they comprise the remaining 20 percent—are paying out of fear."

One student who attended school for only 8 days in January of 1973 received notice a year later that he owed \$1,500 in repayment of a student loan.

Others did not even know that the piece of paper they were signing was a loan obligation.

I have a letter from a person who was led to believe he was filling in an enrollment application when he was actually signing a student loan note. He signed on a Friday and called the first thing Monday morning to cancel his application and was assured there would be no problem. Two years later, he was notified that payment on the loan he never knew he had was now due.

In a variation of "bait and switch" a woman was enticed by a help wanted ad. She applied for the advertised "job" and was told it was no longer available but a similar job would be available if she would sign up for this handy training program. The next thing she knew, she owed the Government \$1,500.

I am focusing here, Mr. Chairman, on consumer protection aspects. Investigative reporting by Gene Ferguson of a Los Angeles radio station, KPOL, has uncovered other information pointing to possible criminal fraud. Recently I have also learned that both the Justice Department and the Los Angeles District Attorney's Office are currently investigating West Coast Trade Schools.

A vast gray area exists, however, between abuses which clearly constitute criminal acts, and noncriminal abuses amounting merely to unethical, misleading professional practices.

One area Congress needs to study is the investigative capability of the Office of Education and/or HEW in relation to the guaranteed loan program. I understand that there is currently a minimal staff, under the Secretary, assigned to security and investigations, but this division was recently cut in size, at a time when it appears clear to me that it may need to be augmented.

Congress ought to determine what exactly the investigative capabilities at HEW are, how they might be improved, and how they might be further implemented to help in this area of abuses in financial aid programs. HEW, and thereby the taxpayer, are presently facing the possible loss of hundreds of millions of dollars.

Clearly a need exists for at least a modest capacity for preliminary investigation within the agency itself—first, to allow for investigation of abuses that might technically come within the letter of the law and to make relevant recommendations; and, secondly, to make preliminary investigations into situations which might subsequently be referred to the Justice Department for criminal investigation with a view to prosecution.

Let me strongly emphasize at this point that I certainly believe postsecondary trade and technical schools are a beneficial and necessary element of our overall educational system. They provide important instruction and training in areas not included in our traditional college and university curriculums.

But we must begin to come down on the minority (or, what I hope is only a minority) of these schools that are misusing Government funds, "ripping off" their students, and discrediting an entire industry.

My concern is with these institutions—the schools which have violated the most minimal standards of decency and professional ethics, schools that have lured unsuspecting persons into training courses of dubious value through misleading claims and high-pressure sales tactics. These schools sign up students when there is virtually no possibility they will ever realize the glamorous career objective so eloquently and deceptively sold to them.

And, tragically, the students so often attracted to these schools are among the most vulnerable of our citizens.

They are usually persons from low-income backgrounds seeking to improve their lot. They are often our veterans. They are not asking for a handout. They are playing by the establishment's rules: Work hard, study hard, get a good job, and you will earn a decent salary. They reasonably believe that if a school is "approved" by the Federal Government under the student loan program, or the GI bill, it must be good.

Imagine their disillusionment when they discover that their Government was used to pull the rug out from under them.

Mr. Chairman, in putting together the bill which Mr. Pettis and I introduced last December, H.R. 11927, we specifically rejected any idea of prohibiting Federal program eligibility for proprietary schools altogether. We also rejected the approach, proposed by some, to create a method of direct Federal approval or accreditation as dangerously intrusive into what should remain non-Federal areas.

Thus, our bill allows for continuation of the present two-step process whereby the agencies of the Federal Government rely on the expertise of non-Federal bodies of approval or accreditation but would require much more stringent standards and supervisory responsibilities.

To achieve this end, we inserted in the bill, with certain modifications, a "shopping list" of result-oriented standards developed by the Education Commission of the States. We would require the Secretary of HEW to develop new criteria based on those in the bill.

A problem which has concerned us is that of placing what amounts to "consumer protection" responsibilities on what are essentially education-oriented entities. The accreditation group which might be able, for example, to evaluate a teacher's qualifications might not be as able to evaluate a school's financial management capabilities.

One possible solution to this dilemma might be an amendment which would require that all proprietary schools participating in the student loan programs be bonded. It is my understanding that surety bonding is a routine requirement in most other Government loan programs. This would constitute a self-policing mechanism involving little intrusion by the Federal Government.

Mr. Chairman, I want to emphasize the urgency of this problem.

We are presently facing losses in the hundreds of millions of dollars; and one informed estimate I have received puts the potential as high as \$1 billion.

Congress must act now. We must act to protect the innocent victims of the fraud perpetrated by segments of the proprietary school industry and we must act to protect the taxpayer. By allowing the use of its name and money, the Federal Government has contributed substantially both to the existence and the magnitude of this problem.

I do not know what all the answers are—and my bill, for which Senator Percy recently introduced a companion bill in this body, does not pretend to be a comprehensive solution. But it does provide a starting point.

I drafted it primarily as a vehicle for hearings—it intentionally raises questions without answering them so that experts could respond. And in recent months experts have come up with a variety of suggestions which merit careful evaluation, and the FTC has proposed certain regulations regarding private vocational and home study schools.

I am glad to see, Mr. Chairman, that you have also focused the expertise of your subcommittee on finding some of these answers.

Thank you.

PREPARED STATEMENT OF HON. JERRY L. PETTIS, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. PETTIS. Mr. Chairman, members of the subcommittee, you have already heard several days of testimony on the general subject of the use of Federal postsecondary education student assistance

funds. Because of our great concern over abuses of such funds, Congressman Alphonzo Bell and I introduced H.R. 11927, the Post-Secondary Education Consumer Protection Act. I am quite pleased that this subcommittee is taking a lead in efforts to solve the serious problem we have.

I suspect that some of the witnesses who have appeared before this subcommittee have been reluctant even to admit that the problem we're talking about exists or that new or stronger Federal initiatives are needed to deal with the situation, over and above the accrediting requirements, consumer protection and fraud laws already on the books.

Frankly, Mr. Chairman, this "don't rock the boat" attitude is just so much whitewash and, in my opinion, pretty disgraceful in the face of what the record shows to be neither a small-scale problem, or a nickle and dime operation.

We're talking about national abuses involving staggering amounts of money, including the estimated \$1 billion which the Federal Government stands to lose on guaranteed student loans that aren't going to be repaid.

Recent stories on the problem that Reader's Digest, the Washington Post, Los Angeles Times, Boston Globe, and numerous radio and television stations across the country have carried will help make the public more wary of the types of dishonest operations that exist in the education field.

These hearings will help, too, and that's good, but just raising the public consciousness isn't enough.

I first became aware of the student assistance funds abuses 2 years ago when some of the young people in my congressional district fell victim to the machinations of Riverside University in Riverside, Calif. The students at this private institution found themselves in financial and academic difficulty when the school became insolvent in 1970 and was closed down by the State of California. Many of the students attending this institution were participating in various Federal student assistance programs. When the school went under, they found themselves with no or very few transferable credits, but with the obligation to repay the entire amount of their student loans. Not surprisingly, many refused to honor their commitments to pay for something they hadn't received. The private loan institutions who advanced the money—also in good faith—turned their claims over to the Office of Education for collection. Settlement attempts are still underway.

Riverside University was originally a small, private proprietary institution, accredited as a business school. Then the school's curriculum was enlarged and additional courses and degrees offered. Despite the fact that the Western Association of Schools and Colleges rejected its application three times, Riverside University publicly promoted its entire curriculum as "accredited"—conveniently making no mention that its accreditation applied only to its business college.

Although school officials were well aware that only business school students were eligible for Federal assistance, a student taking another curriculum was simply registered in the business school and the application made on that basis.

In another unscrupulous practice, the school submitted loan applications in advance. One student was accepted in January 1971 and then applied for a loan, which was approved. The private lending institution sent the loan amount to the school in February, even though the student was not planning to register until the following November and, in actuality, neither enrolled nor ever attended the school.

This is only one in a collection of these horror stories. I am sure the members of this subcommittee are aware of the incidents of a similar nature which appeared in the Washington Post and the Washington Monthly.

Mr. Chairman, the laws now on the books which deal with consumer fraud obviously are not fully adequate to meet the problems which unsuspecting students encounter. The bill which Mr. Bell and I have introduced is designed to fill in the gaps in our legal system and prevent a recurrence of Riverside University fiascos. We propose a little dose of preventive medicine—to tighten up Federal criteria for schools participating in student assistance programs before any more students get "taken."

There is a great deal of precedent for this step, Mr. Chairman.

I can remember reading about the diploma mills of the early 20th century in this country where you could become a doctor in 6 weeks if you came up with \$100. At that time, the Federal Government financed a study of the medical education system throughout the country and as a result, we got rid of the medical diploma mills. Today, everyone who wants to practice medicine must pass a national, standardized examination. The States still are responsible for licensing physicians within their own State boundaries, but those who are licensed must pass one of the national exams.

I believe the adoption of national criteria for participation in Federal student assistance programs, including the G.I. bill, would have the same effect of protecting the public without treading on States' rights.

I'd like to point out that I personally don't consider the terms "proprietary" or "profitmaking" schools are in the same class as an expletive deleted. But I think anybody who refuses to accept the plain truth about the fly-by-night "bad apples" that are in this group is simply burying his or her head in the sand.

At the same time, I know that the Harold Orlans study pointed out some abuses in recruiting students to attend traditional postsecondary schools. This aspect has not gotten as much publicity, but this type of Federal student aid "come on" to bolster sagging enrollments should be halted right along with unscrupulous trade school practices.

Something must be done, Mr. Chairman, to protect postsecondary students and to stop the Federal student aid ripoffs. I believe the legislation Mr. Bell and I have introduced will accomplish this mission and I know your efforts will help us in the effort to enact stronger postsecondary education consumer protection laws.

Thank you.

Senator PELL. Our next witness is Dr. Robert B. Clark, Director of Financial Aid at Oklahoma State University. He also represents the National Association of Student Financial Aid Administrators.

STATEMENT OF DR. ROBERT B. CLARK, DIRECTOR OF FINANCIAL AID AT OKLAHOMA STATE UNIVERSITY, AND PRESIDENT-ELECT OF THE NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS; ACCOMPANIED BY RICHARD L. TOMBAUGH, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

Mr. CLARK. Thank you, Senator Pell.

Senator PELL. I can assure you that if you wish to highlight your testimony, the full text of it will appear in the record at the conclusion of your testimony.

Mr. CLARK. Thank you.

I am Dr. Robert B. Clark, director of financial aid at Oklahoma State University, and president-elect of the National Association of Student Financial Aid Administrators.

I am pleased to have the opportunity to appear before the subcommittee and present the association's views regarding the guaranteed student loan program.

I would like to speak just briefly to the point of current access to the guaranteed student loan program.

Unfortunately, there is a scarcity of current objective data regarding student access to guaranteed student loans. Two problems contribute to this void.

With the exception of a few State guarantee agencies, no formal timely notification is currently provided to the financial aid administrator who certified the student's eligibility for a GSL. Otherwise, the school is advised of those loans insured only through the enrollment confirmation reports provided twice per year.

These listings are cumulative and sorting out current loans is difficult, if not impossible.

As a consequence, the aid administrator is forced to rely upon student and parent feedback—that is, complaints—to determine whether or not applications processed are resulting in actual loans and, if so, in what amounts.

Furthermore, with classes very recently beginning in some schools and yet to begin in others, there has not been an opportunity to analyze the net results in terms of enrollment.

Even that is inconclusive, in that summer earnings often allow fall enrollment, and rejected loan applications are later reflected in failure to register for subsequent terms.

We have, however, asked our membership in a recent newsletter to tell us of any lessening of accessibility over last year's experience.

While each reflects an apparently negative situation in a particular locale, the unknown factor is how many of them were unable to respond to this request because of the timing of it with school having just started, and with other reports being prepared, and the other details concurrent with the opening of a session.

We believe it is safe to say, however, that the program is no better off than it was last year at this time, despite the fact that we have gone back to an assumed needs for most applicants.

Logic would suggest that the current money market and its high prime rate is anything but encouraging to lender participation. Our

recommendations to follow will contain some suggested steps to combat lender reluctance to participate.

The default situation is perhaps as difficult to quantify as access.

While we have an obvious and costly increase in the number and amounts of claims paid from year to year, that data is not entirely sufficient to define the dimensions of the problem, inasmuch as the number of loans outstanding, and thus potential for default, has also been increasing at a rapid rate.

We have been unable to obtain any reliable figures on default percentages, although rumors are easy to come by. That defaults are becoming more of a problem seems evident, but the magnitude of that problem is unknown to us.

Nevertheless, we are concerned about that aspect of the program if, for no other reason, than that the public's perception of defaults may have more of an impact than the defaults themselves.

Support of the guaranteed student loan program (GSL) or any student aid program for that matter, will be rapidly lost if it appears to the lender or the general public that students are taking advantage of the system.

Recent efforts of the Office of Education to tighten controls and expand their collection efforts are to be applauded. We hope that these steps are not "too little, too late" to retain the viability of the GSL program.

As our recommendations will suggest, we feel that improvements in the procedures prior to default are more critical than the post-default collection efforts.

We believe that GSL has conditions built into it which contribute to defaults, and that the correction of these shortcomings is more critical than the addition of more loan collectors.

In talking about the recommendations that we would make for changes in the program, we recognize the need for, and heartily endorse, the guaranteed/insured student loan program. We think it is essential.

It is not a question, we believe, of whether it is a national direct loan or health professions or nursing loan or guaranteed/insured loan, because we believe all are required at optimum effectiveness and funding to serve the credit needs of our students and their families until one well-conceived Federal program can be implemented.

It would perhaps be presumptuous of us as financial aid administrators to make recommendations in the arena of enhancing the attractiveness of the program to the lender. Some plans being advanced to "pool" commercial lender resources do seem to have merit to us, however. Short of broad revisions in the program, we do have some suggestions the subcommittee might want to consider in this vein:

We would extend the Federal payment of interest to cover the period between the time a lender files a default claim and the time of payment on the claim. Some States already provide this benefit. It will not only eliminate one real drawback for the lender in terms of lost income, but it might also motivate the faster processing of claims, reported to be an additional problem to lenders.

We would retain the current 7-percent interest rate, but attach the amount of special allowance to some responsive indicator of the money market so that the lender could get a fair return on the invest-

ment. It seems important to us that the special allowance be predictable in advance rather than being set retroactively, sometimes far into the next quarter.

The psychological impact of reducing the special allowance for the prior quarter at the same time the prime interest rate reaches an alltime high is obvious and should somehow be avoided. The constant interest should be maintained to provide stability in the cost to the student borrower. The current 7-percent rate seems to be a reasonable expectation of the borrower.

We would retain the in-school interest subsidy for those borrowers from families under \$15,000 adjusted annual income requesting \$2,000 or less, with eligibility beyond those points being dependent upon demonstrated need. There would seem to be some rationale for increasing those limits to \$2,000 and \$2,500, respectively. However, our membership has mixed feelings about extending eligibility for the subsidy across the board.

While we have some problem philosophically with the provision of a subsidy to all families falling under this umbrella, and the resultant cost to the program that might be better directed to other student aid programs, we recognize the practical implications of limiting the subsidy through a needs test for all applicants, both in resultant processing hurdles and the unavailability of unsubsidized loans, at least under current circumstances. We prefer at this time to leave this aspect of the program alone and give it a fair chance to work. The cost implications may have to be considered later.

We believe we should exclude the program from the provisions of "truth-in-lending." The borrower is already adequately protected and the red tape is an unnecessary burden to the lender.

There are a series of recommendations we would like to advance to improve the program for the student.

Provide an overall ceiling on borrowing from all Federal student loan programs, rather than separate ceilings for each one. The amounts should be studied and debated, but for sake of example, we suggest the following:

- (a) \$2,500 per year, all Federal programs combined.
- (b) \$10,000 for undergraduate study, all Federal programs combined.
- (c) \$15,000-\$20,000 for undergraduate plus graduate study, all Federal programs combined.
- (d) \$20,000-\$25,000 for undergraduate plus professional studies, all Federal programs combined.

Lest it appear that we are suggesting an expansion of the use of student loans, let me be quick to point out that we are not; this amounts to a limitation on borrowing possible currently. Potential borrowing from existing Federal programs with separate limitations is substantially greater than this proposal. We are concerned that students may be overextending their ability to repay with the current opportunity to combine many loan programs and wish to see a further limitation enacted. Our proposal would continue the authority of the Commissioner to grant an exception, under exceptional circumstances, but the need for such, with adequate support for grants, work, and other aid, should be minimal.

Extend the payment period for graduate and professional school borrowers to 15 years when amounts exceed \$50,000; retain the current minimum monthly payments for smaller loans.

Provide authority for a lender to pay off other educational loans and consolidate all such borrowing into one note and one repayment schedule.

We feel that this would make it easier to meet repayment obligations and avoid default.

Provide specified authority for the lender, at his option, to provide a graduated repayment plan. Not to be confused with an income contingency loan, about which we have grave reservations, the graduated payment would permit a borrower's repayment obligation to begin at a lesser amount and continually increase as earnings increased. Because this approach has some inherent problems, we are proposing that it be offered only as an option to the lender, to respond to special difficulties a borrower might be having with the standard repayment schedule, and only after delinquency seems to be the only other alternative.

We have a few recommendations for the general improvement of the program:

Remove the disincentives for the operation of State-guaranteed agencies. The evidence seems clear, in terms of processing time, lender relations, institutional relations, and other considerations, that this program can be operated more efficiently at the State level rather than at the national level—at least under present circumstances. Yet there is no good reason for a State to perform the guaranteed function at this time, except a desire to provide better service to its residents.

We believe we should provide for the Federal payment of administrative cost for institutional processing of guaranteed/insured student loan applications.

We believe we should provide authority for the State agency or the U.S. Office of Education to contract with the original lender for special collection efforts beyond normal due diligence at the end of the required 120 days, but prior to submitting a default claim.

The original lender already has, in most cases, made contact and has retained contact with the borrower.

The original lender files a default claim because the special collection efforts are cost-prohibitive under the current margin provided.

It is only conjecture, but we would suggest that such an approach would be less expensive to the Federal Government than the maintenance of an ever-increasing collection function of its own. While it would not avoid all claims, and some limitation to the lender's efforts would probably be desirable, it could appreciably reduce the number of claims being submitted by lenders.

Legislatively encourage the issuance of comprehensive certificates or licenses to qualified lenders, giving them a specified blanket endorsement capacity within certain constraints. This would preclude the necessity of processing each and every loan application through the time-consuming endorsement procedure before funds can be advanced to the student.

This is a summary of the formal statement submitted.

Senator PELL. As I understand your statement, you say, just put a limit of \$2,500 on borrowing.

Mr. CLARK. That is just a combination of borrowing under all the Federal loan programs per fiscal year.

Senator PELL. Right. I have one question, somewhat removed from your testimony.

In going through the pages of the material you presented regarding basic educational opportunity grants, I notice it says to the student that within 4 weeks they should receive a student eligibility report which will indicate results of his application.

I will ask the same question of the Government.

My understanding of this provision of the law was that the Government made the calculation, not the financial aid officer making book entry.

What is your understanding?

Mr. CLARK. No. We are currently doing that on receipt of the SER for the student. We are able to calculate at the institutional level what his potential grant will be.

Senator PELL. The reason for this being that the grant can be no more than half the cost of the loan?

Mr. CLARK. Yes. It varies from institution to institution, and therefore it must be calculated on an institution's budget, and it simply is reading from a table, but it is done at the institutional location.

Senator PELL. So there would be no difference in interpretation of the amount between your view and the Federal Government's view?

Mr. CLARK. No. It is simply an application of the cost element at the institution, rather than a basic calculation of grant eligibility.

Senator PELL. Are you people doing this across the country now in public and private institutions?

Mr. CLARK. Yes.

Senator PELL. Does every institution of higher education have a student finance assistance officer? I am thinking, for example, of small school members of my family have attended at various times.

I do not believe that type of school would have one.

Mr. CLARK. I think this is probably true, they do not all have financial aid officers, but someone on the campus will be responsible for the administration of aid. They may have other duties attached to the position.

Senator PELL. It is being alleged that students are taking student guaranteed loans without fully recognizing the financial obligation that they are undertaking.

What is your experience in this regard?

Mr. CLARK. I think this must vary from location to location on where the loan is granted. The origination process is critical, and unless the person originating the loan realizes that there is a special problem in communicating with the student body, it might well be easy for the student to secure a loan and not really understand what his obligations are.

But I think this is something that can be overcome in terms of reliable information than an aid officer or any lender can refer to in making the origination of the loan, and I think it must become a cooperative venture between the lender and the aid officer at the school, where each can contribute to that student's understanding of what his obligations are.

Senator PELL. Do you get involved at all with collection of loans?

Mr. CLARK. Yes, we do. This again is part of the problem that we face at the institutional level.

At my particular institution we have a staff of five people who do nothing but collect the loans, whether they are institutional, direct loans, federally insured guaranteed loans.

We do get involved in a collection effort, but we keep this completely separated from the origination of the loan as such.

Senator PELL. What can be done to discourage the default rate, and also discourage the habit of students going into bankruptcy?

Mr. CLARK. I think the default rate can partially be overcome, as we have just basically touched on, with a better understanding of the student and his obligations to the loan program.

But I think there also needs to be some legislative assistance to us in that regard by eliminating student loans from the Federal Bankruptcy Act, at least for 5 years or so after they have become defaulted.

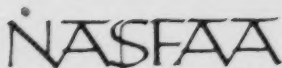
The problem now with the legislation is, as it now stands, a student can declare bankruptcy even before he leaves school, before the loan becomes due, before we have any effort or ability to collect it, and prevent our collecting it before it ever comes into being.

I think some assistance there in the bankruptcy legislation would be extremely helpful.

Senator PELL. Would you send us a paragraph or two for inclusion in the record as to your specific thoughts in this regard?

Mr. CLARK. I would be pleased to.

[The information referred to and subsequently supplied follows:]



NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

September 25, 1974

CENTRAL OFFICE AND PLACEMENT SERVICE
910 Seventeenth Street, N.W., Suite 208
Washington, D.C. 20006
(202) 785-6452

Senator Claiborne Pell, Chairman
Subcommittee on Education
Room 325 Senate Office Building
Washington, D.C. 20007

Dear Senator Pell:

I should like to take this opportunity to thank you again for permitting the National Association of Student Financial Aid Administrators to present before your Subcommittee the problems we envision in administration of the Guaranteed/Insured Student Loans Program. Our testimony spoke to our concerns about the administration of that program, for we realize the major impact that it has and shall continue to have on aid to students seeking post-secondary education.

As you know, one of those problems is the problem we presently are experiencing with defaults. In testifying before your Subcommittee, I touched briefly on the subject of default as it is currently influenced by federal legislation regarding bankruptcy. At that point you asked if I would submit a brief statement to you regarding my opinions on that subject, and I take this opportunity to do so.

The financial aid community which I represented before your Subcommittee consists of some 3,000 persons dedicated to the process of education. Sure, day by day we are concerned with the administration of student aid programs; but, in fulfilling those requirements of our respective jobs, we recognize that the administration of aid programs is simply facilitative of the greater commitment that we have to educating the individual. Further, we look upon the term "education" as involving all aspects of the student's life, whether in class or out, whether on campus or off, as those experiences contribute to his ability to adjust, to live and to succeed in today's society.

Certainly, one of the problems that today's society imposes on its members is the ability to live within a credit-oriented world, a world wherein credit is an essential part of all our lives. Therefore, we believe the proper handling of credit is an essential part of a sound preparation for today's world.

We who spend the major part of our day devoted to providing financial aid to students look upon this as one opportunity we have to contribute to the education of those financially aided students. We have

Senator Claiborne Pell
September 25, 1974
Page 2

the greatest opportunity of anyone on a campus to help that individual understand the importance of credit and how it may be used properly in his daily life. We believe through the student loan programs we administer--through the procedures of originating that loan on through the total repayment process--that we are contributing to the education of our borrowers in the maintenance of their credit standing.

As you know, many of our borrowers do not pay their accounts as they should when they become due, and therefore we must work with them through many devices and techniques to help them bring their payment schedules up to date and maintain their credit history so that it will permit their future use of credit. We are, however, hampered in this respect because of the present bankruptcy provisions of federal legislation.

We are in strong support of the theory of bankruptcy--a legal process which allows persons hopelessly overburdened by debts to list their assets and liabilities, which allows their creditors to share in those available assets, and which discharges any remaining liability. For all federal long-term loan programs there is a nine-month grace period during which the borrower need not make a payment, followed by a lengthy repayment period. It seems that the intent of the federal bankruptcy statute is aborted when a borrower from an educational loan fund is permitted to petition in bankruptcy and thereby is legally able to set aside his obligation to repay that loan fund through a discharge from his debts in bankruptcy, especially during the borrower's student or grace status when these loans make no demand on his income.

We believe, therefore, that all educational loans should be excluded from the kinds of obligations subject to petitions in bankruptcy, founding that belief on the premise that the assets obtained through the educational loan (an education and increased earning power) are not of the type of assets surrendered to creditors by an insolvent petitioner. Thus, since the assets are not subject to creditor participation, we hold that the loan obligation should not be subject to discharge in bankruptcy. Further, we believe that an obligation to a student loan fund--giving rise to increased earning power--has prior claim on the earnings of such a borrower over any subsequent commercial obligation the borrower may see fit to incur.

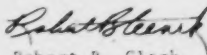
Because of the problems bankruptcy generates in aid program administration, because of its effect on our ability to educate borrowers to their responsibility to society and to the aid program, and because we are committed to prudent administration of public funds, we believe that loans secured for education purposes should be excluded from the provisions of the National Bankruptcy Act. We believe this would help considerably in the collection of many accounts which otherwise will be defaulted; and, even more important, we believe it will facilitate the total education of our clients as we work with them in the judicious utilization of credit.

BEST COPY AVAILABLE

Senator Claiborne Pell
September 25, 1974
Page 3

Again, may I thank you for providing us the opportunity for input to your Subcommittee. If I may provide you any additional assistance, please let me know.

Respectfully,


Robert B. Clark,
President-Elect

RBC:vjr

c c : Mr. Edson W. Sample
President, NASFAA

Mr. Richard L. Tombaugh
Executive Secretary, NASFAA

Senator PELL. What would be your view toward changing the law so that the student would not be eligible for any other type of consumer credit until the education loans was repaid?

In other words, one of the things that concerns me is that the student defaults on his loan, and then goes out and buys an automobile on time.

Mr. CLARK. If this can be accomplished, I would be for it. I think we must make them recognize that their educational loans take precedence over any subsequent loans they may incur.

Senator PELL. My basic view is to see it handled through grants, and the loans be very supplemental. I think it will be many years before we see that.

I thank you both very much for being with us. Your testimony is very helpful, and your specific suggestions will be of help to us, and we will be interested to know your thoughts along the bankruptcy line.

[The prepared statement of Dr. Clark, with attachments, follows:]

BEST COPY AVAILABLE

102

STATEMENT

BY

DR. ROBERT B. CLARK

PRESIDENT-ELECT

NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

BEFORE THE

SUBCOMMITTEE ON EDUCATION

SENATE COMMITTEE ON LABOR AND PUBLIC WELFARE

SEPTEMBER 19, 1974

107
601

Mr. Chairman and Members of the Subcommittee:

I am Dr. Robert B. Clark, Director of Financial Aid at Oklahoma State University, and President-Elect of the National Association of Student Financial Aid Administrators. I am pleased to have the opportunity to appear before the Subcommittee and present the Association's views regarding the Guaranteed Student Loan Program. We have been asked to direct our comments at three aspects of the GSL, accessibility, the default problem, and recommendations for improving the program generally.

Current Access to GSL Program

Unfortunately, there is a scarcity of current objective data regarding student access to Guaranteed Student Loans. Two problems contribute to this void. With the exception of a few state guarantee agencies, no formal, timely notification is currently provided to the financial aid administrator who certified the student's eligibility for a GSL. Otherwise, the school is advised of those loans insured only through the enrollment confirmation reports provided twice per year. These listings are cumulative and sorting out current loans is difficult, if not impossible. As a consequence, the aid administrator is forced to rely upon student and parent feedback (i.e., complaints) to determine whether or not applications processed are resulting in actual loans, and if so, in what amounts.

Furthermore, with classes very recently beginning in some schools and yet to begin in others, there has not been an opportunity to analyze the net results in terms of enrollment.

Even that is inconclusive, in that summer earnings often allow fall enrollment and rejected loan applications are later reflected in failure to register for subsequent terms.

Thus, we are dependent upon two measures -- the endorsement records of the Office of Education, which show an 11.3% increase in the number of loans insured during July and August of this year over the same period a year ago, and the admittedly subjective appraisals of aid administrators based upon their own experience. In the first case, there is reason to believe that this increase may be artificial, coming from more timely processing of applications by institutions due to the removal of the "needs test" for most applicants and from the change in U.S.O.E.'s processing procedure, whereby federally insured applications no longer go to the regional offices for preliminary screening, but directly to the encoder site in Kansas City. One could expect that removing this intermediate step should get the loan "on the books" in a shorter time. Both of these factors have probably expedited processing and may account for part, if not all of the increased volume recorded for the first two months of the fiscal year.

Resorting to the subjective, we asked our membership in a recent NASFAA Newsletter to report any lessening of accessibility over last year's experience to our Central Office. We have attached the responses generated by this request and they are largely self-explanatory. While each reflects an apparently negative situation in a particular locale, the number of responses do not suggest a widespread problem. The unknown factor is whether the other institutions have no real problem or if the aid administrator has been too "swamped" with registration, Fiscal-Operations report, and tripart application for FY 76 funds to advise us accordingly. If it would be helpful to the Subcommittee's deliberations, NASFAA

(2)

would be happy to conduct a more formal survey to collect the desired information.

Based upon the informal feedback received by our Central Office and leadership, it is safe to say that the program is certainly no better off than last year at this time, despite the return to "assumed need" for most applicants. Logic would suggest that the current money market and its high prime rate is anything but encouraging to lender participation. Our recommendations to follow will contain some suggested steps to combat lender reluctance to participate.

Defaults

The default situation is perhaps as difficult to quantify as access. While we have an obvious and costly increase in the number and amounts of claims paid from year to year, that data is not entirely sufficient to define the dimensions of the problem, inasmuch as the number of loans outstanding, and thus potential for default, has also been increasing at a rapid rate. We have been unable to obtain any reliable figures on default percentages, although rumors are easy to come by. That defaults are becoming more of a problem seems evident, but the magnitude of that problem is unknown to us.

Nevertheless, we are concerned about that aspect of the program, if for no other reason than that the public's perception of defaults may have more of an impact than the defaults themselves. Support of GSL, or any student aid program for that matter, will be rapidly lost if it appears to the lender or the general public that students are taking advantage of the system.

Recent efforts of the Office of Education to tighten controls and expand their collection efforts are to be applauded. We hope that these steps are not "too little-too late" to retain the viability of the GSL program. As our

recommendations will suggest, we feel that improvements in the procedures prior to default are more critical than the post-default collection efforts. We believe that GSL has conditions built into it which contribute to defaults, and that the correction of these shortcomings is more critical than the addition of more loan collectors. Without further introduction, I shall proceed to our recommendations.

NASFAA Recommendations

Guaranteed/ Insured Student Loan Program

As suggested earlier in this testimony and in previous appearances before this Subcommittee, the Association recognizes the need for, and heartily endorses the guaranteed/ insured student loan program. It is not a question of NDSL, or health professions and nursing loans or guaranteed/insured loans. All are required, at optimum effectiveness and funding, to serve the credit needs of our students and their families until one well-conceived federal program can be implemented.

Since the success of the guaranteed/ insured loan program depends in large part upon the voluntary participation of the commercial lending community, it would perhaps be presumptuous of us as financial aid administrators to make recommendations in the arena of enhancing the attractiveness of the program to the lender. Some plans being advanced to "pool" commercial lender resources do seem to have merit to us, however. Short of broad revisions in the program, we do have some suggestions the Subcommittee might want to consider in this vein:

1. Extend the federal payment of interest to cover the period between the time a lender files a default claim and the time of payment on the claim. Some states already provide this benefit. It will not only eliminate one real drawback for the

1. (Continued)

lender in terms of lost income, but it might also motivate the faster processing of claims, reported to be an additional problem to lenders.

2. Retain the current 7% interest rate, but attach the amount

of special allowance to some responsive indicator of the money market so that the lender can get a fair return on the investment. It seems important to us that the special allowance be predictable in advance rather than being set retroactively, sometimes far into the next quarter. The psychological impact of reducing the special allowance for the prior quarter at the same time the prime interest rate reaches an all-time high is obvious and should somehow be avoided. The constant interest should be maintained to provide stability in the cost to the student borrower. The current 7% rate seems to be a reasonable expectation of the borrower.

3. Retain the in-school interest subsidy for those borrowers

from families under \$15,000 adjusted annual income requesting \$2000 or less, with eligibility beyond those points being dependent upon demonstrated need. There would seem to be some rationale for increasing those limits to \$20,000 and \$2,500, respectively. However, our membership has mixed feelings about extending eligibility for the subsidy across the board.

(5)

61112

3. (Continued)

While we have some problem philosophically with the provision of a subsidy to all families falling under this umbrella, and the resultant cost to the program that might be better directed to other student aid programs, we recognize the practical implications of limiting the subsidy through a needs test for all applicants, both in resultant processing hurdles and the unavailability of unsubsidized loans, at least under current circumstances. We prefer at this time to leave this aspect of the program alone and give it a fair chance to work. The cost implications may have to be considered later.

4. Exclude the program from the provisions of "truth-in-lending."

The borrower is already adequately protected and the red tape is an unnecessary burden to the lender.

There are a series of recommendations we would like to advance to improve the program for the student:

1. Provide an overall ceiling on borrowing from all federal student loan programs, rather than separate ceilings for each one. The amounts should be studied and debated, but for sake of example we suggest the following:
 - a) \$2500 per year, all federal programs combined.
 - b) \$10,000 for undergraduate study, all federal programs combined.
 - c) \$15,000-\$20,000 for undergraduate plus graduate study, all federal programs combined.
 - d) \$20,000-\$25,000 for undergraduate plus professional studies, all federal programs combined.

BEST COPY AVAILABLE

1. (Continued)

Lest it appear that we are suggesting an expansion of the use of student loans, we are not; this amounts to a limitation on borrowing possible currently. Potential borrowing from existing federal programs with separate limitations is substantially greater than this proposal. We are concerned that students may be over-extending their ability to repay with the current opportunity to combine loan programs and wish to see a further limitation enacted. Our proposal would continue the authority of the Commissioner to grant an exception, under exceptional circumstances, but the need for such, with adequate support for grants, work and other aid should be minimal.

2. Extend the payment period for graduate and professional school borrowers to fifteen years when amounts exceed \$10,000; retain the current minimum monthly payments for smaller loans. The reason is obvious; if larger amounts are borrowed, the monthly payments become overpowering in the ten-year schedule, enhancing the likelihood for default. Even with the increased earning power, the extension seems reasonable.

3. Provide authority for a lender to pay off other educational loans and consolidate all such borrowing into one note and repayment schedule. This would permit a borrower who has utilized more than one program to consolidate all educational indebtedness into one note and one repayment schedule if difficulties in making multiple payments was encountered.

3. (Continued)

We feel that this would make it easier to meet repayment obligations and avoid default.

4. Provide specified authority for the lender, at his option, to provide a graduated repayment plan. Not to be confused with an income contingency loan, about which we have grave reservations, the graduated payment would permit a borrower's repayment obligation to begin at a lesser amount and continually increase as earnings increased. Because this approach has some inherent problems, we are proposing that it be offered only as an option to the lender, to respond to special difficulties a borrower might be having with the standard repayment schedule, and only after delinquency seems to be the only other alternative.

We have a few recommendations for the general improvement of the program:

1. Remove the disincentives for the operation of state guaranteed agencies. The evidence seems clear, in terms of processing time, lender relations, institutional relations, and other considerations, that this program can be operated more efficiently at the state level than at the national level, at least under present circumstances. Yet there is no good reason for a state to perform the guaranteed function at this time, except a desire to provide better service to its residents. In many ways, primarily fiscal, the state is better off allowing the federal government to provide direct insurance, and thus processing. We recommend that the Subcommittee provide greater

1. (Continued)

equity to the states serving the guarantee function, in order that we protect those agencies now operating and encourage others to be formed. I believe the National Council of Higher Education Loan Programs will have more specific proposals in this area. We do believe, however, that certain minimum policies and procedures (consistent loan maximums, for example -- see attachment) should be required from state to state, and that institutions meeting specified capabilities should be permitted to be lenders in all state programs.

2. Provide for the federal payment of administrative cost

for institutional processing of guaranteed/insured student loan applications. Although the demand upon the institution has been lessened by the recent changes in the criteria for the interest subsidy eligibility, there still remains a great deal of paper work at the institution. With operating budgets being reduced, schools are having an increasingly difficult time getting the necessary staff support to process loan applications on a timely basis. The out-of-budget expenses go beyond staff time to include supplies, equipment, travel to loan workshops, etc. Campus budget officers would be more receptive to these demands if a partial reimbursement of expenses were available. We suggest an amount of \$5.00 per loan insured or guaranteed would be appropriate. Although the

(9)

2. (Continued)

costs are incurred on all loan applications processed, not just those approved, the paperwork needed to account for such payment would negate the purpose of doing so.

3. Provide authority for the state agency or USOE to contract with the original lender for special collection efforts beyond normal due diligence at the end of the required 120 days, but prior to submitting a default claim. We have several reasons for suggesting this option:

- a) The longer a past due loan goes before special collection activity begins, the more difficult the collection task. When a loan is turned over to USOE, several weeks, potentially very crucial ones, go by before the paper work permits contact with the borrower. Leaving the account with the original lender postpones that conversion period until it is less important to the collection effort.
- b) The original lender already has, in most cases, made contact with the borrower. USOE or the state agency may have to "reinvent the wheel," so to speak, before the initial contact can be made.
- c) The original lender files a default claim because the special collection efforts are cost-prohibitive under the current margin provided. Federal payment of non-routine collection costs under contract, however, might give sufficient incentive for the lender to pursue collection rather than file a claim. Federal payment of state agency collection costs might also provide additional incentive for them to recover claims on the federal reinsurance.

(10)

d) It is only conjecture, but we would suggest that such an approach would be less expensive to the federal government than the maintenance of an ever-increasing collection function of its own. While it would not avoid all claims, and some limitation to the lender's efforts would probably be desirable, it could appreciably reduce the number of claims being submitted by lenders.

4. Legislatively encourage the issuance of comprehensive certificates or licenses to qualified lenders, giving them a specified blanket endorsement capacity within certain constraints. This would preclude the necessity of processing each and every loan application through the time-consuming endorsement procedure before funds can be advanced to the student.

This concludes my prepared statement. I would be happy to respond to questions you might have.

[From the Atlanta Journal and Constitution, Sept. 8, 1974]

STUDENT LOANS

OUTLOOK STILL DISMAL

(By Nancy Lewis)

What was supposed to be a brighter year for students seeking loans for college is turning out to be as dismal as last year. And loan program officials say last year was the worst ever.

Despite a loosening of financial restrictions on who may qualify for loans—actually, Congress just restated previous financial requirements—the nation's general tight credit situation has almost rendered the revisions moot.

In Georgia, the agency that coordinates the federally insured loan programs this year is receiving more frequent and more frantic phone calls and letters from students and parents than ever before.

The level of student loans is slightly ahead of year-ago levels. Donald Payton, executive director of the Georgia Higher Education Assistance Authority (GHEAC), says.

But last year the total amount of loans was down \$4.5 million from the peak lending of \$13.3 million two years before that (fiscal year 1972). And, too, Payton explained that a new reporting system may simply be getting figures to the agency quicker. He thinks this year's loan totals are perhaps even a little behind last year.

Because of the unavailability of loan funds in the state Payton believes there will be several thousand Georgians who won't be in college or vocational technical schools this fall because they haven't been able to secure the money to go.

Things were supposed to be better this year for the loan program, which for two years has operated under stifling restrictions placed on it by the 1972 congressional amendments to the Higher Education Act.

Before those 1972 amendments, a student whose adjusted family income was \$15,000 or less could qualify for a loan of up to \$1,500 a year at 7 per cent interest. The federal government paid the interest on the loan while the student was in school and guaranteed the loan against default.

But the soaring costs of the interest payments, now running about \$300 million a year, caused Congress to tighten eligibility for the loans.

But Congress apparently went too far. The 1972 amendments made the subsidized loans available in amounts up to \$2,500 per year, but rigid financial needs tests virtually closed the loans to students whose family incomes were greater than \$10,000.

So earlier this year, effective June 2, Congress returned the loan program to its former financial limits. At the time Congress was considering its action, economists were predicting a prime interest rate this fall of around 7 per cent.

But the prime interest rate now is hovering around 12 per cent. And even with the incentive adjustments the federal government pays on the loans, they aren't economically feasible for banks in the current money market.

While the 1972 amendments were in effect, many middle income families were unable to qualify for the loans, and since they are the mainstay customers of banks, some banks were less interested in administering the loans.

There is a little, but not nearly enough, state money to finance loans for eligible students who are unable to find banks with money to lend.

And bank money and state money that is available, the bulk must go to finance renewal loans, Payton said, leaving little for entering students.

Of the projected \$20 million annual need for loans in the state, only about \$8.5 million is expected to be funded this year.

To help ease the situation for next school year, Payton plans to ask the legislature to appropriate money for self-liquidating bonds whose proceeds would go toward stimulating the loan market through refinancing existing loans.

Authority for this type of bond program was approved by both the legislature and Georgia voters in 1972.

The way the bond refinancing would work is that proceeds from the bond sales would be put on deposit at various banks which have participated in the loan programs. The amount of interest the money would draw would be negotiated in advance to be only a fraction above the interest rate to be paid by the bonds.

The bank, in turn, would have to obligate at least the amount of bond money deposited to be freed for making student loans.

Since the payback period would begin within five years on most of the loans, the bonds would liquidate themselves. The administrative costs would be covered by the earned interest, Payton explained, and even the initial seed money appropriation eventually would be returned to the state treasury.

The 1972 constitutional amendment giving the agency bonding capacity limits the amount of bonds which may be outstanding for refinancing to \$72 million. Payton will ask the legislature to appropriate \$1 million which would generate \$11-\$12 million in bonds.

There is a federal program which was created to refinance student loans in a similar manner, but it isn't working too well. One main reason is that it is supposed to be a governmentally-controlled profit-making corporation. That means that the bonds issued by it aren't tax exempt (as the state bonds would be) and also banks must buy stock to be eligible to have loans refinanced.

Outstanding loans in the state now total \$69.7 million.

DICKINSON COLLEGE,
Carlisle, Pa., September 2, 1974.

Mr. RICHARD L. TOMBAUGH,
NASFAA,
Washington, D.C.

DEAR DICK: First I want to thank you for alerting me to the presence of the Pennsylvania congressmen attending the Congressional Reception you sponsored at the National Leadership Conference the end of July. I had a particularly fruitful talk with Dan Flood.

Your July 17 Newsletter asks to be advised if our students are having greater-than-usual difficulties obtaining commercial loans for this fall. I assume that you meant guaranteed student loans.

While I have kept no count, my visceral reaction is that bank refusals for the GSL are running about double the rate of last year this time. I do know that in the last week alone, at least one parent daily has called me to complain that he could not find a participating bank. The picture as I see it is this: Carlisle, PA and surrounding towns have no money for these student loans. Philadelphia has dried up. So has Baltimore. Fort Wayne, Indiana is exhausted. Durham, NC will not lend for out-of-state colleges. The situation is so bad that students who cannot obtain a GSL are forced to take a commercial loan at prohibitive rates if they still want Dickinson.

I certainly hope that you can take the message to the Congress that a major crisis is developing and it will be catastrophic next year if the same economic conditions prevail.

Sincerely,

CHARLES L. TWICHELL,
Director of Student Aid.

GENERAL EDUCATIONAL SERVICES CORP.,
Los Angeles, Calif., August 1, 1974.

Mr. RICHARD L. TOMBAUGH,
Executive Secretary, NASFAA,
Washington, D.C.

DEAR MR. TOMBOUGH: In response to an article I recently read in the NASFAA Newsletter, I would like to report to you that banks in many states where we do business have established new policies which limit or curtail FISL lending.

Our wholly owned subsidiary, the United Electronics Institute has schools in twelve states. These schools are primarily in the mid-West and South. We are fortunate to have our own Lender Number and are making a much larger percentage of our loans ourselves than we did one year ago. At that time we had four or five banks assisting us in making loans, without much concern as to the geographic location of the students. Presently, we have two banks loaning only to local students.

I know you are doing what you can to influence a rate change at HEW to make these loans more attractive to the banks. I believe the special HEW allowance limitation should be increased to at least 4%.

Please do not hesitate to contact me if I can provide you with any additional information.

Very truly yours,

JOHN H. MILLER.

THE UNIVERSITY OF ALABAMA IN BIRMINGHAM,
Birmingham, Ala., July 31, 1974.

Mr. RICHARD L. TOMBAUGH,
National Association of Student Financial Aid Administrators, Washington, D.C.

DEAR MR. TOMBAUGH: In the *NASFAA Newsletter* of July 17, 1974, you requested institutional feedback on problems with *GSL's*.

UAB student requests and applications for *GSL's* are up 15%, while approvals are down over 30%. This is for the period September, 1973, through May, 1974.

The removal of the need's analysis on most loans has helped very little. At this time last year our approvals were down 40%, but the total dollars loaned were about the same as this year. In other words, while the total number of approvals has risen 10%, the total dollar amounts has stayed about the same.

When the new regulations were issued earlier this year, local lenders dropped the maximum amount they would lend. Under the need's analysis system some lenders would approve loans of \$2,500, now none of them will. The average loan in 1973 was \$1,200; so far in 1974, the average loan has been for \$900.

Within the past month one of our largest local lenders dropped out of the program, leaving a number of students without a source of funds. Rumor has it that another local lender will drop out by December, 1974.

If the present trend continues until June, 1975, our total number of loans will be down 30% over June, 1974. In effect, students will have available to them only about 55% of what was available in 1971-72.

The result has been near panic on the part of students and their families. Our office is asked daily, "What can I do, where can I turn?" Today alone, three students brought *GSL's* forms back to me saying that the lender they had previously used would not make them a loan because they (the lenders) were no longer cooperating in the *GSL* program. One student in Medical School, needed \$2,000, and had gotten that amount last year from a local bank. This morning, he came in and told me that his bank would now loan him only \$1,000, in spite of the fact he has had a good account there for three years.

It is not, (to use the bank's term) the "poor risk" student that is being turned down, it is *all* students. In short, we're in trouble. To add to our woes, Health Profession Programs funds are down 25% over last year, and College Based Program funds are little better. BEOG is a failure, and has had little impact. Sixty-seven of our 7,000 undergraduates got \$20,058 in BEOG.

I can provide you with more exact data if you need it, but you get the idea. There is a gap between promise and delivery. The poor student (read "poor risk") is out of the *GSL* market, the middle income student is getting cut back and the school's enrollment is hurting. The federal government says plenty of money is available in the private sector, and the private sectors say *GSL's* are unprofitable. Well, so they are, but then so are bombs and bullets. Students are very profitable, but they are the fall guys in this dilemma.

The lenders and my Trustees are worried about defaults. As of February, 1974, our students have gotten 3,517 *GSL's* and 13 of them are in default—.0007%. Down the street, "Slick Sell Business College" approved 1,225 *GSL's* and has 402 defaults—.33%?

In the confusion a lot is being missed, mostly, the lack of educational equality. The poor are getting poorer, the rich richer, and the middle-income are getting crunched. Somehow this seems all out of joint with what it's all about. More important, is that students are beginning to feel this way too. It makes one angry to be the victim.

Sincerely,

W. J. WALKER, Director, Student Financial Aid.

UNIVERSITY OF MISSOURI-KANSAS CITY,
STUDENT FINANCIAL AID OFFICE,
Kansas City, Mo., July 31, 1974.

NATIONAL ASSOCIATION OF STUDENT
FINANCIAL AID ADMINISTRATORS,
Washington, D.C.

GENTLEMEN: In the July 17th *NASFAA News Letter*, you asked that we notify you if our students are encountering greater than usual problems in obtaining commercial loans for this fall. In response to that request, we have contacted five lenders in the Kansas City area who in the past have been the primary lenders to

our students. Our contacts confirmed that students are indeed experiencing greater difficulties this fall. Summarized below are the reactions as expressed by those lenders:

Lender No. 1.—This bank is making very few loans now. Basically they are giving loans to children of customers and to returning loan recipients. They will review each case individually but are making only limited loans.

Lender No. 2.—This bank has not changed its policy. It is still loaning money on the Federally Insured Loan with bank customers given first preference. Non-customer applications are being held. If funds allocated for the Federally Insured Loan are not used by customers prior to August 15, the lender will issue limited loans to non-customers.

Lender No. 3.—No loans are being made to new applicants. They are terminating previous borrowers as soon as they reach their immediate degree objective. They will not carry them beyond the current degree. They are limiting recipients to a maximum of \$1500 per year.

Lender No. 4.—No new loans are being made. The bank will continue to fund loans to students already in the program. They have indicated that they will again become more active if the prime rate drops.

Lender No. 5.—This lender is accepting applications only from students whose parents have an established account with the bank. Even so, they are making very few loans. They will review applications from returning recipients, but will make no broad commitments. Each application is being reviewed on an individual basis.

In addition to these five lenders, we have learned that the American Bar Association no longer can process Federally Insured Students Loans through its lender in Chicago. They are attempting to locate new lenders but no success has been experienced to date. We have also been notified that the United Student Aid Fund has placed a moratorium on loans which were being handled by a Dental Hygiene Association. I assume that this moratorium will continue until interest rate drops.

I hope this information is useful to the Association. At the University of Missouri-Kansas City, the Federally Insured Student Loan picture is a very uncomfortable one, especially so for those students who do not qualify for National Direct Student Loan consideration.

Please let me know if I can supply additional information.

Sincerely,

MICHAEL A. NOVAK,
Director.

GEORGETOWN UNIVERSITY,
Washington, D.C., July 31, 1974.

RICHARD L. TOMBAUGH,
Executive Director, NASFAA,
Washington, D.C.

DEAR DICK: I am writing to confirm and elaborate on some of the points discussed in our phone conversation of last week.

As you know, Georgetown has committed itself to become substantially involved as a lender in the Federally Insured Student Loan Program. It is our announced intention to escalate our level of lending up to approximately \$7 million over the next six to eight years. This is made possible by an understanding reached with the University Finance Division of the First Chicago Corporation in which University Finance has agreed to make loans to Georgetown, the proceeds of which would be loaned to students under the FISL Program. The University has agreed to absorb the cost of administration and collection while the interest rate is passed on to the students and the federal government under the provisions of the FISL Program.

As you know, the escalation of interest rates over the last year threatens to have serious effects on the viability of the FISL Program. The inflexibility of the 3% maximum rate for the special allowance is a particularly serious threat to programs such as the one at Georgetown since we are not in a position to balance in offering of loans at a lower interest rate with another offering at a higher interest rate. Unless action is taken by the Congress to allow the special allowance to float upward in concordance with the money market, it will be very difficult for institutions such as Georgetown to maintain this type of program. This is quite distressing to us as the program was initiated very largely as a source of aid funds

to middle income students who are not eligible for other types of financial assistance. We have announced our intention to make unsubsidized FISL loans freely to students who do not qualify for the subsidy or the interest benefits. It is an opportunity that is not available generally through the banks.

In your contacts with legislators and other interest parties, I hope you can bear in mind the needs of institutions which have adopted this concept of making loans available to students.

Sincerely,

JOSEPH A. CHALMERS, Ph. D.,
Dean of Admissions and Records.

WASHINGTON STATE UNIVERSITY,
Pullman, Wash., July 24, 1974.

Mr. RICHARD L. TOMBAUGH,
Executive Secretary, NASFAA,
Central Office and Placement Service,
Washington, D.C.

DEAR DICK: I am taking this opportunity to apprise you of a Federally Insured Student Loan problem in the state of Washington that is not directly related to the impact of the current commercial money market upon the availability of insured loans, but the end result is similar. Earlier this month all post secondary institutions were notified by Washington Mutual Savings Bank that they have suspended participation in the FISL program due to the unreasonable delays in the Office of Education's processing of interest payments. Their frustration is understandable in that their correspondence regarding the problem goes unanswered by O.E.

Ed York as well as congressional representatives have been apprised of the problem. Washington Mutual has over \$500,000 due in outstanding interest payments. At the present time they are the major FISL lender in the state of Washington. Washington Mutual suspended participation a year ago on a temporary basis until the interest reimbursement was received. Officials of the bank indicate they need more assurance that interest payments will be on a regular basis before they will again participate in the program. This means that a high percentage of students in the state of Washington will not be able to secure Federally Insured Student Loans from Washington Mutual in time for fall registration. Other banking institutions being far more restrictive in their consideration of applicants will doubtfully have much of an impact upon these remaining loan applicants.

I should appreciate any intervention with the Office of Education that you deem appropriate.

Sincerely,

(Mrs.) LOLA FINCH,
Associate Dean of Students.

ARMSTRONG STATE COLLEGE,
Savannah, Ga., July 24, 1974.

EDITOR, NASFAA NEWSLETTER,
910 Seventeenth Street,
Washington, D.C.

DEAR SIR: In your NASFAA Newsletter of July 17, 1974 you asked for responses concerning the availability of insured and guaranteed student loans from commercial lenders. It has been brought to my attention on several occasions that students were being turned down for loans by commercial lenders in our area.

In many cases we find it impossible to meet a students' full need and it is necessary for the student to turn to a commercial lender, but it is getting impossible to find a lender agreeable to give a student a loan, especially a new incoming student.

I am sending this letter with great concern, let's pull together and fight for the student.

Sincerely,

H. ALLEN BALDREE,
Assistant Director,
Student Financial Aid.

MIDWEST BUSINESS COLLEGE, INC.,
Colorado Springs, Colo., July 24, 1974.

NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS,
 910 Seventeenth Street NW.,
 Washington, D.C.

DEAR SIR: I am writing this letter in response to your newsletter of July 17, 1974, regarding the article, "Access To Bank Loans."

We operate five private business schools in the state of Colorado and there are no banks in our trade area making Guaranteed Student Loans with the exception of the United Bank of Denver.

The banks tell us that considering the high interest rates in the general money market and the low interest on GSL loans plus the administrative and collection problems have made these loans very unpopular.

I hope this information will be useful to your office.

Cordially,

THOMAS J. GRAY,
President.

EDISON COMMUNITY COLLEGE,
Fort Myers, Fla., July 26, 1974.

Mr. RICHARD TOMBAUGH,
 NASFAA,
 910 Seventeenth Street N.W., Washington, D.C.

DEAR MR. TOMBAUGH: I am enclosing a copy of a recent letter received by me on the insured student loan situation.

There are still two banks in Fort Myers who will lend but I believe it is only to their own depositors. There is no bank in Naples who is lending in this program. Mostly now we recommend that the student applies to the state since Florida is a lending institution in the guaranteed loan program.

I hope this information will be helpful in your efforts to inform Congress of existing situations.

Thank you for your continued efforts.

Sincerely,

WILLIAM P. WOOD,
Director of Financial Aid.

Enclosure.

BARNETT BANK OF FORT MYERS, N.A.,
Fort Myers, Fla., July 23, 1974.

Mr. WILLIAM WOOD,
 Financial Aid Director,
 Edison Community College, Fort Myers, Fla.

DEAR MR. WOOD: The management of the Barnett Bank of Fort Myers, N.A., has decided to discontinue its participation in the Federal Insured Student Loan Program. We plan to continue to fund those students to whom we have previously made loans until they have completed their education and graduated.

We appreciate your cooperation with us in our efforts to assist your students with their educational expenses.

Very truly yours,

ROBERT A. PURCELL,
Senior Vice President.

BELLEVUE COMMUNITY COLLEGE,
Bellevue, Wash., July 24, 1974.

RICHARD TOMBAUGH,
 National Association of Student Financial Aid Administrators,
 910 17th St. NW., Suite 228, Washington, D.C.

Dear DICK: After reading the July 17th NASFAA Newsletter, I thought you'd be interested in the status of FISL in the Seattle area. With Washington Mutual out of the program, loans for community college students are almost non-existent.

Keep up the good work.

Yours truly,

FRANK P. BOSONE,
Director of Financial Aid, Bellevue Community College.

Enclosure.

631

124

[The Seattle Times, July 22, 1974]

BANK OUT OF STUDENT-LOAN PROGRAM

(By Julie Emery)

The Washington Mutual Savings Bank, a giant in the field of student financial aid, has dropped out of the federal government's guaranteed-student-loan program.

J. Denman Morrison, vice president for loan administration, described the program nationally as an "administrative nightmare." There are serious day-to-day operational problems, delays in settlement of claims and a constant struggle to get valid, consistent information from program officials, he said.

"They're not performing their part of the obligation," Morrison said.

He referred to the bank's participation in the program as a "temporary withdrawal."

"We don't feel that we can commit any more dollars to it until the operational difficulties have been clearly corrected," he said.

Since the program began, the bank has made loans totaling about \$28 million. Morrison estimated "that current balances are around \$22 million."

The bank is the largest lender in the state under the program and ranks 15th nationally.

Washington Mutual is the third-largest financial institution in Washington.

In a recent reorganizational move, the long-term loan program has been placed under Edward York, deputy commissioner for management in the Office of Education, Washington, D.C. Previously the program was called the Division of Insured Loans and was under the associate commissioner for higher education.

York was out of town and unavailable for comment. Morrison said he informed York of the bank's decision in a letter July 3 but has had no reply.

Julia E. (Judy) Hamblet, acting director of the program for Region I of the Department of Health, Education, and Welfare here, said the Bank of Newport, Ore., also has dropped out of the program "for similar reasons."

She acknowledged administrative problems, but added that "we're seeing an improvement in management." She noted that York went into the position actively only two months ago.

Miss Hamblet noted that lenders in this state have put \$79 million into the program since November, 1967, and that this involved 78,000 loans. Washington Mutual, dollarwise, has made 35 percent of the loans.

Under the program, interest for the lender is 7 percent quarterly, plus an allowance or bonus of up to three percent, depending on market conditions. The bonus for the quarter which ended in June was 3 percent, making a total of 10.

The withdrawal has nothing to do with the fact that the prime interest rate for lending has skyrocketed to 12 percent. Morrison said, stressing that the large dollar involvement indicates the bank's firm commitment to student financial aid.

Morrison indicated that there have been long-simmering problems with the program, and that he could recite many "horror stories."

For example, he said, in the settlement of claims—when they are presented to Washington—officials there assign a settlement claim number. The bank has to submit claims identified by name.

"For many, many months they refused to notify us what the claim number was. Thus, when they finally paid the claim, we had no way to match it up to the name. That finally was cleared up."

Morrison said that the 7 percent "face rate" and bonus traditionally have been paid "sometime approaching six weeks following the end of the quarter."

"In the quarter ending in March, it (the payment) was more than 10 weeks late. We're talking about losses totaling \$4,000 to \$5,000. . . ."

Morrison said the event which precipitated the decision to withdraw from the program occurred in late June.

"We were notified by people at H.E.W., who represent themselves as authorities, no claims would be processed for settlement in June because they were undergoing a reorganization of their audit, or some such explanation.

"They then said that, because they were shifting their claims-processing structure from H.E.W. in Washington to local regions, there would be an additional two to three months before claims again would be settled.

"We find that just utterly intolerable. We don't feel we can continue to put our depositors' funds . . . into a program with that kind of protection."

As it turned out, Morrison said, the bank did receive some claims this month.

"We don't know if that's because we yelled or because we got inaccurate information to begin with," he said.

The incident illustrates the uncertainties with which the bank has tried to live, he said.

Morrison also noted that "we have claims pending on defaulted loans that are over 15 months old."

He also stressed that Washington, D.C. officials are not keeping the regional office informed, that often the bank is more up to date on operations or events than the government field offices.

Miss Hamblet, who heads the program for Oregon, Idaho, Alaska and this state, said nation-wide about \$6,888,000,000 in loans have been made. There are more than 20,000 lenders.

In this region there are about 600 lenders "actively participating" at this time, she said. About 250 colleges and universities are involved.

"The lending community has been remarkably faithful to what they regard as taking on a community obligation," she said. "I'm convinced Washington Mutual will go back into the program."

Authorizing legislation for the loan program expires June 30, 1975, she said. Thus "the whole program is up for congressional hearing."

SEATTLE UNIVERSITY,
OFFICE OF FINANCIAL AID
Seattle, Wash., July 30, 1974.

NASFAA CENTRAL OFFICE
Suite 228, 910 Seventeenth St. N.W. Washington, D.C.

GENTLEMEN: In reference to Volume VI, Number 3 "NASFAA NEWS-LETTER", dated July 17, 1974—you requested information on the problem of finding hard evidence of lender resistance to making FISL.

I am enclosing a clipping from the Seattle Times dated Monday, July 22, 1974 which speaks to the entire problem of the FISL as it affects the State of Washington.

One of the saddest aspects of the situation is that the banks still remaining in the program refuse to give a loan to those who had previously borrowed from Washington Mutual.

I think you should have enough with this one case to blow HEW right out of a Committee hearing, as Washington Mutual is the 15 largest lender in the program.

My school president immediately notified our Senators as well as Representative O'Hara of Michigan, stressing that loans are the main-stay of Private post-secondary institutions of higher education. Quite frankly, without Washington Mutual willing to make loans, the FISL program in the State of Washington will be completely inadequate.

Sincerely yours,

MICHAEL J. DOLAN,
Director of Financial Aid.

Enclosure as stated.

THE UNIVERSITY OF ARIZONA,
Tucson, Ariz., May 17, 1974.

Memorandum to: For the record
Regarding: Bank policy on FISL

Recent legislative changes are opening the Federally Insured Student Loan Program somewhat so that more students now will qualify for the Guaranteed Bank Loan. Whereas all applicants were required to fill out the ACT Family Financial Statement under the old regulations, only those students with an adjusted family income of over \$15,000 or those students applying for more than \$2,000 will be required to complete the ACT in the future. The new law becomes effective on 2 June 1974 and will apply for all bank loans for the 1974-1975 academic year.

Unfortunately, due to recent rises in the Prime Interest Rate and the Discount Rate at the Federal Reserve, many banks are growing restrictive in their policies regarding accepting the FISL loan application.

Southern Arizona Bank will no longer accept a FISL application from a student unless he has a prior Guaranteed Bank Loan with them. In addition, SAB is lowering their maximum awards to \$1,000 for regular students, \$1,500 for graduate students, and \$2,000 for medical students. All students applying for the loan

through SAB or Valley National Bank must be maintaining at least a "C" average. Students applying to these two banks will be required to get a "R-27" form from the Registrar's Office.

Virtually all local banks are requiring that a student who is applying for the loan have had a checking account with that bank for at least six months prior to submitting his application.

We have had little feedback from the out-of-state banks or from the various state Guaranteed Loan agencies, but it seems virtually certain that the majority of lending institutions across the country will be growing more restrictive in accepting bank loan applications and in the amount of money they will award to students.

MICHAEL GRACE,
Administrative Assistant.

THE UNIVERSITY OF ARIZONA,
TUCSON, ARIZ., May 31, 1974.

Memorandum to: Mr. J. J. HUMPHREY, Director, Office of Scholarships and Financial Aids

Regarding: Status of the Federally Insured Student Loan Program with Respect to the Newly Implemented Federal Legislation and the General Economic Condition

Encl (1): Memo FOR THE RECORD dated May 17, 1974

The situation remains much the same regarding the Federally Insured Student Loan program since our last communication. The new guidelines will go into effect on June 2, 1974, and remain the same as outlined in Enclosure (1).

Mr. Rudy Mappus of the Department of Health, Education, and Welfare conducted a two hour seminar regarding the new Federal guidelines. As I explained to you in our last conversation, I spoke with Mr. Mappus at some length following that meeting in an effort to clear up some rather vague points in the new processing instructions.

Subsequent to this meeting we have encountered several problems over the period of time which constitutes an "academic year". As you know, the H.E.W. people consider this to be a nine month period while lending institutions consider it to be a calendar year. As a consequence of this disagreement, we may encounter some processing problems with those students who are applying for summer school in addition to the 1974-1975 academic year.

I spoke with Mr. Clyde Parker of the Valley National Bank in Phoenix today regarding this particular problem. He agreed that Mr. Mappus had responded to my question in such a way as to indicate that a student who received an award for the 1973-1974 academic year and is subsequently applying for summer school, is beginning a new nine month cycle. Mr. Parker spoke with the Kansas City office earlier today, but received only a response to the effect that, "Yes, this is a problem." He hopes to have more clarification soon.

Mr. Parker indicates that Valley National will be making the loan in the amount of \$1500 per two-semester academic year, and \$500 per summer school. The situation appears to remain the same as before with Southern Arizona, First National, and Arizona banks.

State Loan Programs With Less Than \$2,500 Maximums:

Arkansas.....	\$1, 500
Connecticut.....	1, 500
Delaware.....	1, 500
District of Columbia.....	1, 000
Georgia.....	1, 500
Illinois (Freshman \$1,500 Sophomore \$2,500 Juniors and Seniors)....	1, 000
Louisiana.....	1, 500
Maryland.....	1, 500
Michigan.....	1, 500
New Hampshire.....	1, 500
Nevada.....	1, 500
New York (Freshman and Sophomore \$1,750 Junior \$2,000 Senior)....	1, 500
Oklahoma.....	1, 000
Oregon.....	1, 500
Rhode Island.....	1, 500
South Carolina.....	1, 500
Vermont.....	1, 500
Virginia.....	1, 500

Senator PELL. The next witness is Mr. Jay Evans, president of the National Council of Higher Education Loan Programs.

One question I hope he discusses is the question of class or categories of schools and institutions which do participate in the federally insured student loan program but which do not participate in the State insured loan programs. It seems to me that the States may have a better default rate than the Federal program, since they limit participation in their guaranteed student loan programs to the more well-established or traditional institutions of higher education, as opposed to the Federal program which is more inclusive.

In considering changes in existing law, our committee may well be forced to evaluate particular classes or categories of institutions which are not participating in State programs against higher default rates in those classes or categories.

I am thinking, for example, that many States do not allow participation in their State-guaranteed program by students who are taking courses in a home study program, while the federally insured loan program does permit such participation. The question naturally arises; does the Nation benefit more by having persons participate in home study programs than it loses by financial setbacks which may result from defaults on loans for those persons?

Mr. Evans, will you identify those accompanying you?

STATEMENT OF JAY W. EVANS, PRESIDENT, NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS; ACCOMPANIED BY CAROL WENNERDAHL OF ILLINOIS; BILL NESTER OF NEW JERSEY; AND RON IVERSON, EXECUTIVE DIRECTOR, STATE OF VERMONT STUDENT ASSISTANCE CORPORATION

Mr. EVANS. Mr. Chairman, before we get into the discussion of the questions that you posed, I would appreciate it if I could make a few short comments.

Senator PELL. Certainly.

Your entire statement will appear in the record at the conclusion of your testimony.

Mr. EVANS. Mr. Chairman, we are very concerned over what we heard in your hearing of yesterday morning. We have a prepared statement which we intended to deliver to you today. Instead we would just ask to submit it for purposes of the record, because those of us who attended the hearing yesterday feel that we should address some of the statements made yesterday.

Because our plans have been rearranged, we ask your understanding regarding the brevity and informality of our testimony.

Senator PELL. Certainly.

Mr. EVANS. As president of the National Council of Higher Education Loan Programs, I would like to respond to one aspect of the Office of Education testimony.

I find it difficult to understand why you were told that they could offer you no comparable State guarantee agency default data.

Frankly, one of the reasons our prepared statement speaks not of default statistics, but rather of some of the problems and suggested cures, is that we had every reason to believe that the Office of Education would be furnishing you with data, summarized from reports which we furnish them quarterly.

Well over 3 years ago, it was our organization which stepped in to fill the need for a common definition of the default rate. We devised a reporting form. We have voluntarily submitted such a form quarterly for 3 years.

If today there is no common data between the Office of Education and the State guarantee agencies, it is because they, not us, have deviated from the agreed upon reporting format.

Our raw default numbers, comparing the number of borrowers no longer in school and subject to repayment are not calculated to put us in the most favorable light. We have been reporting figures unreduced by subsequent repayment.

Not having access to a calculator last night, I did not attempt to take all of our quarterly reports submitted by virtually all 26 of our guarantee agency States, to add them up and average them out. I thumbed through them instead.

What I read was gross percentage rates of 5, 6, and 7 percent. If we wanted to exclude those students who have paid, or who are now paying us, we could easily make a statement that somewhere between 95 and 98 percent of the students who are subject to repayment in our programs are making repayment to either the lender or the guarantor.

We believe there are valid reasons why State guarantee agency's default rates are significantly lower than the rates presented yesterday in the Federally Insured Student Loan Program.

If our States have a lower default rate than the Federal program, I believe it is indeed due to many of the administrative efforts we have tried and shared with each other. But certainly on an equal plane with the administrative expertise, is the statewide financial aid philosophies which understand the limited roles loans can play in student assistance.

Many of our States believe the loan program must be kept in their proper place, and these States believe that the role of loans in financing the education of low-income students should be minimal.

Senator PELL. Would you repeat that?

Mr. EVANS. Many of our States believe the loan program must be kept in its proper place, and these States believe that the role of loans in financing the education of low-income students should be minimal.

Senator PELL. In other words, you think we should have more grants and less loans?

Mr. EVANS. We are saying, sir, that if the priority in this program is for the middle-income student, as was intended by the 1965 legislation then you should put more emphasis on grants to the lower-income individuals.

These States are firmly wedded to a strong grant program, with only a modest requirement of some form of selfhelp—work, loans, and savings, if any, for the low-income student.

And when I speak of modest self help, I am speaking of hundreds of dollars each year, not thousands. I am speaking of a self investment of barely sufficient size to act as a depressant to educational costs which would tend to react dramatically to a grant program which is pledged to meet 100 percent of the cost established by the schools.

Mr. Chairman, we stand on our past statements. We oppose the increase in the loan maximum from \$1,500 to \$2,500, because we feel this unduly emphasized loans and overburdened students.

We have promoted this program as a sort of last resort only. We still believe that this program is most appropriate for middle-income borrowers.

I believe that our major problems were visited upon us when we lost sight of some of the basic intents of the 1965 legislation. I believe our problem started when we became the receptacle into which was dumped the rejected students of underfunded alternative programs.

If this process could be reversed, with alternative programs adequately funded in such a manner as to not encourage costs to be proportionately raised, then the demand for this program and the default rate of the program would recede to a manageable size.

Mr. Chairman, I promised brevity, so that we could have time to fully respond to your questions.

At this time I would like to ask Mrs. Wennerdahl from Illinois, Mr. Iverson from Vermont, and Mr. Nester from New Jersey, to share their default experience with you.

Their remarks will be limited to 2 to 3 minutes.

Mrs. Wennerdahl.

MRS. WENNERDAHL. Mr. Chairman, subject to your questions, my remarks will be exceedingly brief.

Before the hearing I gave your staff a copy of some default statistics by type of educational institution, which my staff put together for me last month.

As Jay mentioned in our testimony, this is one of those reports that are published for everyone to see. It is raw default data, unreduced by any subsequent repayment.

Essentially what it tells you is that for every 100 of my students who go into repayment, 6 of them are going to default. I can tell you we are collecting from about 2 of that 6 now, meaning we still are pursuing 4 of the 100 students that go into repayment.

I have broken the default data down by type of school, as you requested. It shows one thing quite clearly to me, and to my collector as we pursue those students. The main thing you will see from looking at these reports is that the high default schools are the ones that serve low income students, students that we have questioned whether or not should have a substantial requirement to borrow in the first place.

Since you addressed the subject of home study schools in your opening remarks, and since you can see an absence of home study institutions on my report, let me simply say this.

I think it would be of interest to you to know that home study schools do not seriously affect the Federal programs default rate either, because the large home study institutions are not filing any defaults except death, disability, and bankruptcy.

I happen to have the three largest home study institutions in the country in my State. They now represent 25 percent of the monthly national FISL volume. I have no residency requirement in my State for those students wishing to attend institutions in my State.

Quite simply, the reason that Illinois does not help those three home study schools is that at this time, with my State legislature taking a look at the fact that they could follow Iowa's example and get the

FISL program for free, they are not going to let me drastically increase my administrative costs by serving those three home study schools in my State who serve about 90% non-Illinois residents.

Because of the home study schools, the Illinois FISL volume is twice as much as ours. But, I think with some better understanding the costs that are to be borne by the Federal Government and by the States in this program, and the various degrees of risks that we need to share, the subject is quite negotiable with many of our States.

Mr. EVANS. Thank you, Carol. Mr. Iverson.

Mr. IVERSON. Mr. Chairman, my name is Ronald Iverson. I am the executive director of the State of Vermont Student Assistance Corp., which administers a statewide grant and scholarship program, guaranteed student loan program, and the talent search program.

To be brief, Vermont's loan program began in 1964. We were the first State to accept Federal seed money for loan reserves under the Higher Education Act of 1965.

During fiscal years 1968 and 1969 virtually all loans in Vermont were processed under the Federal Insured Loan Program (FISL) and not the State guarantee agency, because our loan reserves were encumbered and the benefits of reinsurance were not yet available.

Without the corporation requesting discontinuation of the Federal Insured Loan Program our lenders recognized early that the Federal program suffered from a lack of sufficient personnel, adequate management, and program stability. As a result, our lenders independently decided to direct their participation in the student loan program be directed strictly through their State guarantee agency.

The current default rate in our State guarantee program is 3.7 percent, calculated by placing all claims paid to our lenders for reasons of bankruptcy, and failure to repay over our matured paper. This is not the same analysis used by the Office of Education when they testified yesterday regarding the Federal loss rate—If we used a similar analysis, our loss rate would be 1.6 percent, compared to the 12-percent projected loss rate for the Federal Insured Loan Program.

Certainly the fact that Vermont is a small rural State attributes to this favorable rate. But we also believe our loss rate is low because we have utilized some sound managerial practices, such as coordinating with high schools, colleges, TRIO programs, Welfare offices, 4-H Clubs, et cetera, to insure that counselors are provided accurate information to students regarding their loan obligations prior to the acceptance of a loan. Semi-annual group meetings are held with such groups and each is individually visited once a year.

Mr. Chairman, we believe that good loan repayment begins when students have correct information regarding their future debt obligations.

We also work closely with our lenders to insure due diligence.

We do not rely on lenders to contact credit bureaus upon a student's default. We assume this responsibility. In fact, we inform the credit bureau of every loan guaranteed, thus providing information to would-be creditors regarding every student borrower's existing financial obligations.

This is a step which does help prevent bankruptcy, as it is more difficult for a student to overburden himself with loan debts that could lead to insolvency.

We believe the economic scale, and effective statewide coordination with other governmental departments also leads to our excellent loss ratio. For example, our office receives from the Vermont Department of Taxes all income tax refunds that would have normally been refunded to a borrower who defaulted this loan. These refunds are credited to the defaulted borrower's loan account.

Mr. Chairman, that is the end of my comments, and we would be happy to send you any additional information regarding our default prevention and pursuant programs.

We are from a State where we have experienced very different programs.

Senator PELL. We were thinking of this income tax thought yesterday. I wish you would enlarge on your thought on that.

Mr. IVERSON. Very simply, our attorney general's office has instructed the department of taxation to refund any income tax refunds that a student files for, from a Vermont tax return, to our office, if he is a defaulted borrower.

Senator PELL. In other words, the money is used to repay the loan?

Mr. IVERSON. Absolutely.

Senator PELL. What about the State of Vermont? Is that money not needed for carrying out the budget expenses in the State of Vermont?

Mr. IVERSON. We are part of the State of Vermont.

Senator PELL. You are talking about refunds.

Mr. IVERSON. Just refunds.

Senator PELL. It is very rare that you get a refund from any Government agency.

Mr. EVANS. Mr. Nester.

Mr. NESTER. Mr. Chairman, I first want to say that I am not aware of the comments made in yesterday's testimony, so I am ignorant somewhat of what has preceded.

For brevity, because I believe the importance of this is in responding to questions of concern that you can voice on behalf of yourself and members of your committee, I would like to make just a few observations as to some of the causes which I think are underlying the defaults, as to the general pattern.

I think we can divide them into three general categories.

First of all is the matter of overindebtedness on the part of the student.

Sufficient attention is not paid to the total indebtedness of an individual, only the immediate debt that an individual has undertaken.

I know we hear comments about how we always check credit references, we do this, we do that, but we personally have experienced a number of situations where individuals who have rather large loans of \$4,000, \$5,000, or \$6,000, get a brand new car loan for some \$3,500, and in not too long a period they are after the student who defaults on his note, and frequently the car payments are current but not the student loan payments.

Also in the matter of overindebtedness it is quite common to hear students comment—I might say not only students but people in general—credit is so easy to get. It is so easy to live on somebody else's money.

I think this is something that we should be concerned about. It certainly is one of the underlying causes of our young people defaulting.

Another area of concern is the present state of the economy.

We are all aware of some of the effects of inflation.

It is very common for a parent to say to a son or daughter, get a student loan, the loan will help me out of a bind at the present time, and I will help you with your payments later on.

It is surprising how many times a student will say, dad intended to help me, but he is not in a position to do so now.

Sometimes, there is even conflict where the students and parents have separated, because the student suddenly is left with a rather sizable debt that he cannot repay at that time.

Another concern, of course, is the matter of unemployment.

At the present time, as unemployment mounts, there is a tendency—you can ask anyone who has dealt with credit over a long period of time—for the credit picture to become a bit gloomy. This is happening in student loans.

People who are overqualified for some jobs cannot get immediate employment. I refer to the group of qualified teachers who presently are unemployed.

The third general area is simply a matter of attitude. Attitude I think, can be categorized in three ways.

First of all, you have the student who says, "I will borrow now and worry about repayment later. I am really not concerned with this debt at this time."

He has not had business experience prior to this.

You cannot get blood out of a turnip, which is the old adage you have heard before.

The Government will take care of it, which is becoming more and more predominant—I am not going to worry about it because the Government will take care of things later. If I cannot pay, somebody will be there to help me.

On the part of the lender, I think you find a matter of a lack of counseling, if you will—financial counseling.

In New Jersey, where we had a program that began operation in 1960, initially the banks made these loans in purely a counseling situation where they sat the student down and discussed with him the step he was about to take, his future obligations, and so on.

Now, it is the situation where students that come in in droves, literally in droves, and some lending institutions provide for general counseling sessions, group sessions, if you will, but many of the institutions provide no counseling at all for this debt about to be undertaken.

There is also an ignorance on the part of many of the lenders, and when I say lenders I am talking about financial institutions or schools as lenders, an ignorance on their part as to the total indebtedness of the individual with whom they are dealing.

Look at the school again. There is the matter of inadequate counseling time after time. We have students say that they have not had adequate counseling.

The question was raised earlier by Commissioner Bell about the matter of staffing financial aid personnel in institutions.

Yes, there is a shortage, and I think if you look further into the facts concerning financial aid officers, you probably would be shocked at the turnover in financial aid personnel in those institutions where experience is very short—1, 2, or 3 years perhaps.

One other point is, of course, something that many of us have experienced, and I think my colleagues will vouch for this, a lack of cooperation that guarantee agencies have received from some educational institutions.

By that I mean when a call is made, trying to determine a recent address of a student about to go into default, or who has defaulted, the records are closed to you. They will not provide any recent address or any information about the student.

Of course, here we very seriously raise the question, should we exclude that institution from our list of eligible schools?

To this date, we have not taken that step. I hope it will not be necessary.

I think what we must do as business individuals, and even as a council, is to think more in a positive way.

Here I am referring to the articles that appear in the media which always stress the negative. This is the default way. It is an easy way of life to obtain a loan, declare default and consequently declare bankruptcy.

Recently, several articles appeared on the matter of bankruptcy. Some people said why did you not respond?

Well, if bankruptcy ever replaces streaking, we are in serious trouble.

We have to state the position positively. We have to stress the number of these people who are meeting their obligations, their responsibilities, and repaying their loans. We have to tell these young people, in very clear terms, the steps that will be taken if they fail to meet their obligation and spell out what the ultimate result will be for them.

Thank you for this opportunity.

Senator PELL. Thank you very much indeed.

There is one thing I am a little confused about.

You sounded very annoyed and changed your procedure, but I do not quite understand at whom you are annoyed, Mr. Evans.

Mr. EVANS. I think our basic reason is that it was mentioned to you yesterday that there were no default statistics from State guarantee agencies to compare with FISL default statistics.

We have been submitting for 3 years, practically all of us, quarterly claims and collection reports which have been used or could have been used to compile comparable information.

Senator PELL. My recollection was—I am not sure how they expressed it—but I believe they said that they did not have the responsibility. And when it was gone into, counsel mentioned you were coming here today.

I am not sure that they do not have your information. What they said is these figures were not on the national model from which the GAO got them. And since you were coming up today, we deferred a discussion until today.

If you have the figures in front of you from the model, do you find those figures way out of line with your own results?

Mr. EVANS. I think Carol has information from her State in this area.

Mrs. WENNERDAHL. Mr. Chairman, I have been looking over the data as some of my colleagues have been talking.

Senator PELL. Is that page 1?

Mrs. WENNERDAHL. The page is obscured here. I think it is page 1. Yes.

As I look through the information that is in this report, it is my perception—correct me if I am wrong—that this model is indeed based on the FISL program, is that correct?

Senator PELL. That is correct.

Mrs. WENNERDAHL. I can make these couple of comments.

First, I think their projection rates were based on historic performance, and they claimed yesterday that with their new management and new personnel being put into this area, they said the future would not reflect the past.

All I can tell you is this.

If my statistics in the next 5 to 10 years ever reflected this for any one of the categories, my State fiscal officer would put me out of business in a minute.

It shows the same general relationship between types of institutions for the reasons mentioned earlier—

Senator PELL. In other words, under the State programs, the proprietary schools have a default rate approximately four times that of the colleges?

Mrs. WENNERDAHL. The proprietary schools and our community colleges, because of the types of students they serve, do have a higher risk population than do historically the average 4-year institutions.

I think the FISL model shows that phenomenon also. I do not plan to ever see statistics in my program as high as those projected in the FISL program. I doubt if my colleagues ever do.

It would be ridiculous for us to go to our State officials and project that future experience.

We would have the FISL program in Illinois overnight if they did not have any more confidence than this in their State program.

Mr. EVANS. Commissioner Bell has the information that we have gathered for their use from our quarterly claims and collections reports.

Senator PELL. I am sure he does.

Do you have as much money available?

Is it as easy for a student to get a loan from your group as it is from the Federal?

Mr. EVANS. Office of Education reports will show that the state programs have retained commercial lender participation to a much greater extent than the FISL program has done. As you know, the money market is very tight. We are concerned about students getting new loans. We must do something to improve this.

As far as I know most students requesting renewals have been getting loans—we are getting loans for renewal students in Pennsylvania. We are not getting new loans as we expected, but we are working quite closely with our various lending associations and lenders to get more money.

Senator PELL. If your figures are correct, and I would like you to take this model, which is not the model which is agreed to by HEW, I would like you to jot down alongside this model and submit it for the record your own figures, and if you are correct in this, maybe one solution would be to eliminate the program on the Federal level and have it completely handled on a State level.

I have no preconceptions. I just want to make this thing work better. And I could be persuaded to introduce an amendment to that effect.

What do you think that would do?

Mr. EVANS. Senator Pell, I will do my best to get as many States as I can to submit the data. I can assure you that this information will be compared, if possible.

I also have a committee working on a new claims and collection report. When this report is implemented we will get that information back to you.

[The information referred to and subsequently supplied follows:]

CLAIMS AND COLLECTION REPORT

Default rates by type of institution are being gathered from as many state agencies as possible. In some instances, special computer time must be approved and scheduled. I do not believe that the data I will secure will be suitable for combination into a single summary. These reports are individualized, internal management tools devised by each agency, often for different purposes. Some agencies state the data in terms of accounts, and some in terms of dollars. Some contain data only on those accounts where pursuit is legally possible, and others include death, disability and bankruptcy claims. There has not been a great amount of effort to standardize reports of this detail because of the costs involved to the states and the anticipation of the Office of Education's default model serving this purpose.

Senator PELL. Can you furnish this information I am talking about for your 24 or 26 States?

Mr. EVANS. For the larger States, yes.

You must understand that the smaller States are not computerized and they will have a difficult time in collecting this comparable data.

Senator PELL. We would like that within the next 3 weeks when these hearings will close. And we would like it in columnar form next to these figures we have.

You may say this is for the 14 States, or 24, or whatever the total is. Let me give you my thought.

If what you are saying is that you have a record of performance, a track record here, that is three times better than the Federal Government, would it not be a direct savings to the taxpayer if this program were entirely State administered and not federally administered?

Mrs. WENNERDAHL. Yes.

I did want to respond to your earlier question about the difficulty of getting loans in a State program versus the Federal program, because I think, in addition to the default rate, this is also a key question that I am sure you had good reason for asking.

While Jay was giving his response, some figures popped into my head of some data that I put together about 3 months ago from some Office of Education reports, giving the comparative volume for fiscal year 1974, and the last year we had in the program prior to the Education Amendments of 1972, fiscal year 1972.

In comparing the guarantee agency volume and the Federal volume, if I recall, at the time I did that report, the last volume available was the first 7 months of both fiscal years.

There were some very interesting comparisons. It showed that the guaranteed agency volume was off 13 percent for the 1972 fiscal year. The Federal volume was off 23 percent. This is very deceptive.

As I mentioned earlier, 25 percent of their volume is coming from three schools in the Federal program, and if those three schools were to be removed, the loss of commercial lenders' support in the Federal program goes to 35 percent compared to our 13 percent.

If you can take some further suppositions that I think research will prove correct, probably over half of their problem is coming from three dozen schools or so. This leaves the students who are attending the other 7,000-plus schools in the FISL State in dire straits.

Senator PELL. Thank you very much.

We are going to have to finish this session shortly.

Am I correct in saying that in very rough terms your track record, looking at the table in front of you, is about three or four times better, which would be about three times better than Commissioner Bell said the figures were as of now?

This is very, very roughly.

Mrs. WENNERDAHL. I have not checked the record.

Senator PELL. Who is the president of the group?

Mr. EVANS. I am the president. Carol is my liaison person who works with the reports. And for this reason, she has presented comparable figures for her State.

Senator PELL. Just say yes or no.

Is that correct?

Mr. EVANS. I would say, yes, that is correct, sir.

Senator PELL. If that is correct, I would think it would be very much in the public interest and along the lines of public policy when everything can be done equally efficiently or more efficiently on a State level than a Federal level, it should be done on a State level.

This seems to suggest reason for moving this program to a State level.

However, am I also correct in saying that one of the reasons for your better track record is that you are much more chary about including home study institutions and proprietary schools?

Mr. EVANS. That, if you recall, is correct.

Only a few States include home study schools.

Senator PELL. That is what I am saying.

You are more chary. You are more reluctant to include in the State programs that type of school where the high default is.

Mr. EVANS. That is correct.

However, the home study institutions are filing only death, disability, and bankruptcy claims in the federally insured student loan program.

Senator PELL. They do not what?

Mr. EVANS. They do not file all defaults.

I am told they do not file except for death, disability, and bankruptcy.

For this reason, they are not significantly contributing to the Federal default rate.

Senator PELL. Let us deal, just for a moment, with the category 1 group.

The total eventual default rate on the average will be 15.4 percent according to this model.

According to HEW, it will be about 12, as I understand it.

It would be about four according to your record.

I am looking at exhibit 2, page 1, the first block there.

Mr. EVANS. Yes, that is correct.

Senator PELL. I think these are very interesting.

You have both the question of saving the taxpayer money and also the national policy.

The only drawback to moving it to the State level for admission, is that there would be many students who would be getting loans from the Federal Government who would not be eligible to get them from you.

I would be grateful if you would prepare for us a listing of the categories of institutions which, as a general rule, would be institutions where a student would not be eligible for State loans, and then the national interest will come in as to whether we will judge that the lack of the institutions would justify the retention of the program by the Federal Government.

Mr. EVANS. We will get this information for you.

Senator PELL. Also I would be interested in knowing the total number of people on the payroll administering this program in toto in the States.

I want to see what the efficiency is compared with the Federal Government.

Mr. EVANS. I do not think there is any question that we can come up with statistics from most of the National Council Member States on these questions.

Senator PELL. I am not asking you for a position. I am asking you for figures.

Mr. EVANS. Figures will be provided.

[The information referred to and subsequently supplied follows:]

CATEGORIES OF INSTITUTIONS INELIGIBLE FOR STATE LOANS

With the following exceptions all eligible schools are served by the guarantee agencies. Home study schools are not eligible in state programs of Arkansas, Delaware, District of Columbia, Illinois, Louisiana, Maine, New Jersey, New York, North Carolina, Ohio, Oklahoma, Vermont and Virginia.

Because of the state's constitution, a student attending a theological seminary or school of theology is not eligible in the state of Pennsylvania. As was previously stated, it should be noted that it has been reported that the three largest home study schools who function as their own lenders (and who currently represent one quarter of the federal program's current monthly volume) are filing no default claims except for death, disability and bankruptcy.

PERSONNEL INVOLVED IN GUARANTEE LOAN PROGRAM TO STATES

For each state and private, non-profit guarantee loan program, the following chart shows the average, full-time equivalent personnel including the dollar amount of loans guaranteed as of June 30, 1974. I have not attempted to extract from this total figure the various categories of personnel since our agencies share certain specialized personnel such as data processing staff, state regional staff, accounting staff, and various other areas with other state programs. Many times the state program does not only work with loans but also grants, work-study programs, talent search programs, etc. Therefore, some of the staff figures include the best estimate of that portion of shared staff which could be dedicated to the loan program.

Also it must be emphasized that states differ as to services provided its lenders, schools and students to meet the needs and philosophy of that particular state.

New York, Georgia and Ohio for example, include staff to bill the federal government for interest subsidy on behalf of their lenders. This function alone adds to staffing requirements in the states.

States	Average, full-time equivalent personnel	Dollar amount loans guaranteed
Arkansas.....	6	19,716,570
Connecticut.....	27	203,888,979
District of Columbia.....	5	11,051,273
Georgia.....	20	69,549,958
Illinois.....	38	275,351,167
Louisiana.....	20	40,292,502
Maryland.....	8	34,047,854
Massachusetts.....	18	170,653,385
Michigan.....	21	106,188,175
New Hampshire.....	3	17,698,788
New Jersey.....	26	295,095,988
New York.....	172	1,086,519,043
North Carolina.....	13½	25,268,813
Ohio.....	26	143,954,762
Oklahoma.....	5½	27,811,102
Oregon.....	15	50,322,960
Pennsylvania.....	70	562,693,473
Rhode Island.....	5½	40,764,545
Tennessee.....	6	44,879,959
Vermont.....	4	8,570,016
Virginia.....	6	63,118,315
Wisconsin.....	5	81,899,432
U.S. Funds ¹	62	387,295,006

¹ U.S. Funds administers guaranteed student loan programs under contracts with (1) schools and colleges, (2) professional organizations and corporations, (3) several State governments, and (4) the Federal Governments' Office of Education. It operates nationwide, under the Higher Education Act, as a private not-for-profit corporation. It maintains 2 of its own offices: An executive office in New York City, and a central processing office (endorsement center) in Indianapolis, under contract with a commercial collection agency, a collection-billing office in Columbus, Ohio. And, while U.S. Funds does not have its own collection staff, it does place defaulted loans with professional collection agencies under a contingency fee basis. However, the State programs for Alaska, Delaware, Maine, Nevada, South Carolina, Virgin Islands do not maintain separate staffing, but use those of U.S. Funds. In addition, 1 of the States for which it acts as "agent," the State of Maryland maintains a separate staff in Baltimore.

Senator PELL. I thank you very much, indeed.

Mr. EVANS. Thank you, Mr. Chairman, for the opportunity of appearing before you.

I do hope our remarks are helpful.

Senator PELL. The prepared statement of Mr. Evans along with statements of those who could not attend and other pertinent material submitted for the record will be printed at this time.

[The material referred to follows:]

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS

Jay W. Evans
Pennsylvania
President

William C. Hesser
New Jersey
President Elect

Robert P. Zeigler
Ohio
Treasurer

(Mrs.) Owen Davis
North Carolina
Secretary

Donald E. Payton
Georgia
Past President

Statement by

Jay Evans, President

National Council of Higher Education Loan Programs

Before the

Subcommittee on Education

Committee on Labor and Public Welfare

U. S. Senate

Thursday, September 19, 1974

10:00 a.m.

Mr. Chairman and members of the committee:

It is indeed an honor for me as President of the National Council of Higher Education Loan Programs to appear before you today to discuss the subject of student loan defaults. In talking with some of the other Council members as to how we might be most helpful to you on the subject, it was felt that since the Office of Education would be testifying concerning the statistical aspects of the default question, we could contribute the most by a short discussion concerning the causes of and some possible cures for the default question.

Student Financial Problems

As would be expected, there is a certain percentage of our students who have defaulted on their loans simply because they were unemployed or overextended financially. For obvious reasons, these defaults are the most difficult to prevent, and, therefore, our Council's position has always encouraged policies which would not further aggravate this problem. It was for this reason that we opposed the increase in the loan maximum from \$1,500 to \$2,500, and it was partially for this reason that we encouraged the retention of an interest subsidy which would keep the program's costs to the borrowers at a manageable level. However, this is not our largest or most serious cause of defaults in the opinion of our staffs. If it were, we could replace most of our collectors and skip-tracers with financial counselors whose simple duty would be to renegotiate a more suitable repayment schedule or a reasonable period of deferment for the financially embarrassed borrowers who would otherwise willingly repay their loans. We believe that other factors are at work which cause the default problems.

School Origination of Loan Paper

Any experienced installment credit person will testify that there is the need for a great amount of lending psychology which must be utilized in order to optimize recoveries.

If we are to instill in our borrowers a sense of serious obligation and grave responsibility, the only effective time to form and modify borrower attitude toward repayment is at the time the loan process is originated, before the receipt of the earnestly sought money. Students' minds are the most open and impressionable at that time.

Some data has emerged in the last year or two which sheds some light on who can most effectively perform this loan origination process. The Office of Education data shows that the average dollar delinquency (as opposed to defaults) of loans which are in repayment, but are more than 30 days past due, consists of about 10% of the average lender's portfolio. Where schools function as lenders and originate their own loan paper, the delinquency rate soars to 37.3%. The popular conception has been that this has been a problem generated by proprietary schools, because the default rates for students attending proprietary schools and community colleges have been demonstrably higher than similar rates for students attending four-year colleges and universities. However, an additional possibility, long overlooked, is the fact that proprietary schools were among the first to become lenders or agree to assist a cooperative commercial lender with handling the loan origination paperwork. What is interesting about the new data is that it shows that the colleges and universities have no better a delinquency record when they become lenders and originate their own guaranteed loans. In fact, their experience is almost identical.

It has been difficult to get good data on the National Direct Student Loan Program delinquencies, where the accounts now in repayment almost exclusively were originated by colleges and universities. While a direct comparison of such loans and guaranteed loans can be somewhat misleading, some data revealed by the Office of Education in a statement last May before another Congressional committee is interesting. The data indicated that \$1.84 billion in National Direct loans is now or has been subject to repayment. Of this amount, loans whose disbursed balances total \$490 million are now past due. If one can make the assumption that the average loan is somewhat comparable

in these two amounts, this means that slightly more than one out of every four National Direct borrowers who are no longer in school are delinquent in the repayment of their loan. It was because of this data, and our belief that the factors which we feel lead to higher delinquency when schools originate loan paper, factors which we feel cannot be effectively controlled by legislation or regulation, that our Council was led to recommend that the role of schools acting as lenders under our program should be severely restricted or eliminated altogether.

Delinquency Deterrent

Continuing with our theme that a great amount of psychology is required in order to optimize student loan repayments, our borrowers must be convinced that delinquent accounts will be pursued vigorously and continuously. In the earlier days of our program, and even to some extent today, we suffered from many students' understanding of the National Direct Student Loan collection efforts as related to them by other students. The advice from other students often was to see if they could get away without paying. Many students were told if they sit through a couple of form letters and maybe one phone call, they'd never be bothered again. We feel that many students who would not otherwise have done so decided to test our perseverance because of the historic "soft" image of student loan collections. If this image is allowed to persist, millions of dollars will be lost needlessly simply because students will not believe that the government would spend the required effort to trace them to their current location and repeatedly contact them to the extent necessary to affect repayment.

Unfortunately, too much of the efforts of our experienced collection staff today are spent in the costly and laborious task of skip-tracing many "relocated" borrowers, rather than in the more productive task of negotiating repayment arrangements with the accounts. It is for the purpose of minimizing the program's losses through the twin strategies of dissuading wavering students from the temptation of testing our

resolution, and directing more of our collectors' time to actual negotiation with delinquent borrowers, that the Council seeks a more efficient means of locating missing borrowers. It was only after much consideration, with full knowledge of the political sensitivity of the issue, and with a great amount of personal reluctance, that we decided that it was our professional obligation to explore with legislators the possibility of obtaining authorization to retrieve student addresses from current social security records. We felt compelled to at least address the subject for two reasons. First, there is the question of the propriety of the Department of Health, Education and Welfare annually requesting high sums of money for the purpose of locating borrowers whose address already is on file with the department. But more important to our decision was our realization that we are not addressing the question of whether or not an individual's privacy should be violated. We are mandated to violate the delinquent borrower's privacy. The only issue to be discussed is the manner in which it is to be violated, and we see two options. The first option is the relatively inexpensive alternative of quietly locating an address from existing files, thereby assuring the confidentiality of the borrower's delinquent status. The other alternative is our current practice of the employment of costly, time-consuming, and often indelicate telephone skip-tracing procedures which must leave in its wake a trail of alerted and curious references, relatives, neighbors, and associates. It is for this reason that we felt our request for consideration of the first alternative would be justified and defensible.

Also needed as a further deterrent to needless default losses is legislation to prevent the recent graduate of ridding himself of \$5,000 worth of educational debts by the simple act of filing a bankruptcy petition. Our Council suggests that the program might be better served and the losses minimized if bankruptcy legislation were amended to prohibit student loans from being dischargeable in a bankruptcy action during the in-school period and during an additional minimum period of five

years following the beginning of the repayment period. We have no desire to continually harass a borrower in genuine financial distress. In fact, our collectors could not afford to waste their time pursuing an account where it is apparent that there is no significant income or assets. Usually, such accounts are merely marked for periodic review to determine if circumstances have changed. The bankruptcy amendment which we recommend would have its greatest value as a deterrent to those borrowers who only seek to "rip off" the government by filing for bankruptcy on graduation day, before a job is sought and any assets are accumulated.

The Complexities of Loan Prepayment

A small, but troublesome, factor in our default problem is a well-meaning legislative provision which essentially discourages many lenders from contacting the student on a timely basis after graduation. We've been instructed that the legislation authorizing a nine month grace period before the beginning of repayment absolutely prohibits a lender from scheduling an earlier first payment -- even if the student insists that he wants his schedule and coupon book to be prepared on an earlier date. The acceptance of prepayments during the grace period involves such administrative complexities that many lenders actively discourage such payments.

We believe that the student's rights can be adequately protected against the demands of the occasional overzealous lender by permitting the student to request and receive a repayment schedule which begins before the ninth month, but with the understanding that the lender could not consider the account to be in default until 120 days after the ninth month. This feature would take from the lender any incentive to insist that an unwilling student begin repayment prematurely. We also believe that the program could be further improved by providing for the same manner of exception to the minimum five year repayment schedule, thus permitting a student to request a repayment schedule which would retire the loan at a faster rate. In this case also, protection such as that described could be legislated to protect students from overzealous lenders.

Administrative Resources

The state agencies have been putting forth their best efforts in the prevention and recovery of defaulted loans. However, the current structure of the enabling legislation often makes it risky for many of us to approach our state fiscal officers with requests for adequate resources to be at our peak efficiency. Even with the federal reinsurance of 80% of our default losses, our states must bear all of the program's administrative expenses and the 20% balance of the default losses. As the program becomes more and more expensive to administer, our state fiscal officers look with renewed interest at our neighboring states who bear no program costs and no default losses because those states chose to make no investment, thereby letting the Federally Insured Loan Program be implemented there. Every year when budget requests are submitted, many of our members, fearing that any additional extra expenditure might be the straw which breaks the camel's back, ask for a couple of less collectors' salaries than they really need to do the most efficient job. Research and data analysis become luxury items, a fact which frustrates us at a time like this when your need for data is so critical. But the simple fact of the matter is that some of our small agencies must question whether they dare ask for a couple extra \$400 calculators in their budgets, much less \$10,000 more for a research position or extra computer time.

To date, we have been able to demonstrate to our state fiscal officers that the state agencies have been far more effective in the retention of commercial lender support of the program than has the federal program during the last couple of troublesome years. A comparison of the volume data in light of the fact that 25% of the national federal program's volume is now coming from only three home study schools, with the probability that over 50% of the federal program's volume is coming from less than three dozen schools, shows the desperate plight of the student who wishes a federally insured loan from a commercial lender to attend one of the other 7,764 schools. But this fact can be limited in its persuasive powers when state officials must weigh the

value of the additional volume we can generate against the promise of the cost free federal program.

For us to be able to acquire the necessary resources to administer the program with optimal efficiency and minimal default loss, we must first gain some stability and security within our own states. We must have removed the constant threat of having to "go federal" if we should ask for one additional staff member too many. Therefore, to remove the disincentives currently in the law which discourage new and continued state investment in student loans, the Council asks that serious consideration be given to legislative amendments which would make equal the federal investment level in this program for all states, at whatever level you might deem appropriate.

Conclusion

In closing, Mr. Chairman, I would like to assure you that we share some of your concerns regarding this program as you stated them in the September 5 Congressional Record. We welcome a study of the most basic aspects of our program, including its purpose, its structure, and even its continuation. We have for some time suffered from a lack of direction and certainty of purpose as we watched this program grow from an essentially middle-income program to what appeared to be a low-income program, and now to a program of uncertain mission. We are aware that certain program problems will remain regardless of what system is chosen to deliver loan money to students. We are lending to a young borrower of uncertain future, whose credit worthiness never having been previously tested, is precarious to say the least. The loan funds are fully without collateral or security, and the first repayment obligation is often years distant from the initial disbursement. With those program liabilities inherent in any student loan program, many experienced credit personnel are quite surprised that the recovery records are as good as they are.

You have now had experience with two widely divergent forms of student loan delivery mechanisms in the National Direct program and our guaranteed program. We welcome and even urge close scrutiny of the effectiveness and cost of both alternatives. The direct program derives its lending capital from appropriations. Our program capital is obtained from the private market. Our program has required the appropriation of dollars to cover the interest expenses incurred by the use of private capital. The direct program borrowers enjoy a similar interest free loan, which we feel is no less costly to the tax payer simply because it represents, instead, a revenue loss associated with its non-income-producing investment status -- although we will admit the latter does have the advantage of a greater amount of obscurity. The ^{National} Direct program enjoys the status of having definite appropriate limits which can be set without undue pressure for greater numbers of loans. But this fact is due in large part because there exists a guaranteed program which unfortunately must suffer the stigma of having open-ended and uncontrollable expenses because it must function as the safety valve which accommodates those students not adequately served by the limited funding of the direct program and other forms of student assistance. The summer of 1972 showed us all what happened when that safety valve no longer offered relief to an irate borrowing populace.

^{National}
The Direct program has in repayment now loans almost exclusively originated by colleges and universities. We urge examination of the efficiency of this delivery mechanism by comparing similar data on guaranteed loans disbursed to colleges and university students.

Your weighing of these factors cannot be an easy task. Nothing worthwhile ever is. I ask that you give consideration to our urgings as being the sensible approach to a problem that affects hundreds of thousands of students and how they will finance their future through payment of their higher education costs. Thank you for the opportunity of appearing before you. I do hope these remarks will be helpful to you in your future deliberations.

THE AMERICAN BANKERS ASSOCIATION,
GOVERNMENT RELATIONS
Washington, D.C., October 3, 1974.

HON. CLAIBORNE PELL,
Chairman, Subcommittee on Education, Committee on Labor and Public Welfare,
United States Senate Washington, D.C.

DEAR MR. CHAIRMAN: The American Bankers Association appreciates this opportunity to comment on the Guaranteed Student Loan Program's default problem.

We have actively supported this program from its inception. In fact, of the nearly \$7 billion advanced in 7 million loans, as of June 30, 1974, our member banks have made 70 percent of those loans. It is evident, therefore, that the commercial banking industry is greatly interested in the Guaranteed Student Loan Program. In substantial measure the continued viability of the program rests on the willingness of students participating in this program to honor their borrowing commitments.

For this reason we have an overriding interest in the default program. It should be noted for every dollar in default, there is one less dollar available for educational programs. The increasing rate of defaults also adds to the feeling of frustration and disenchantment many lenders feel about the program.

When we initially attempted to analyze the default program, figures supplied to us by the Office of Education, as of June 30, 1974, indicated the current default rate was 6.8 percent of all loans in the repayment status. We attempted to compare these with installment loans and home mortgages that were in default as of June 30, 1974, and these figures were less than one-half of one percent. We felt at that time, considering the fact that no credit judgment was involved, that the default rates were high but not unworkable provided the Office of Education increased its collection endeavors.

However, estimates supplied to your Committee by the General Accounting Office indicate that 24.3 percent of loans are in default and testimony by the Commissioner of Education projected defaults in the range of 14.5 to 18.5 percent.

These rates are intolerable, and Congress and the Office of Education must take immediate steps to remedy this problem. We feel that it is essential that the Congress and the financial community get reliable figures on defaults and delinquencies, not just as to the volume but also by class of lender.

The most current figures available from the Office of Education do shed some light on where the greatest amount of delinquency (as opposed to defaults) occurs. This is where the schools serve as lenders. The delinquency rate for vocational schools was 31.85 percent, while higher education schools stood at 34.41 percent. If these figures are valid, then a sharp curtailment of school lending activities seems a must. We suggest such a curtailment be accomplished legislatively.

We believe the majority of defaults arise mainly from inability to pay. Thus, a distinction should be made between students who default due to unemployment and other extenuating circumstances and those who are merely unwilling to meet their obligations.

Following are some specific recommendations that we feel would reduce delinquencies and defaults:

1. In the case of students who are unwilling to repay, all existing agencies of the Federal Government should be fully utilized to collect the defaulted loan. A determined and well-publicized effort in this direction could produce dramatic reduction in the rate of default.

2. In the case of those students who default due to unemployment or other extenuating circumstances, we would suggest that the Federal Government work out some equitable method of repayment for the student. For instance, a plan only requiring payment of interest on the defaulted loan could be worked out. Under this plan, a full payment schedule would be resumed as soon as practical.

3. Pre-loan consulting by the lender as to the student borrower's responsibility and obligation to repay is most essential.

4. After the loan application has been forwarded to the loan guarantee agency for review and endorsement, a copy of that endorsement, plus a letter defining the borrower's responsibility and obligation both to the lender and the Government should be forwarded to that student borrower.

5. Schools should be compelled to notify lenders when a student graduates or withdraws, and furnish the lender with the student's last-known address and home of record.

6. When a loan has been delinquent for a period of 60 days, the lender should be required to notify the guarantee agency. This should trigger pre-claim assistance by the agency to the lender.

7. For a number of students, level monthly payment schedules may be inappropriate, especially in the early years of the payback period. To respond to this need, an optional or graduated repayment schedule is recommended.

8. Finally, we would suggest that the Office of Education be empowered to use the Social Security Administration to help in "skip tracing." This recommendation has caused us a great deal of concern because of its potential abuse to an individual's right of privacy. For this reason, we do not feel this information should be made available to lenders but only to the Office of Education.

We thank you for allowing us to present our views on the problems besetting certain aspects of the Guaranteed Student Loan Program. We will be happy to assist you in any further way we can in resolving these problems.

Sincerely,

GERALD M. LOWRIE.

CONNECTICUT ASSOCIATION OF
STUDENT FINANCIAL AID ADMINISTRATORS
September 10, 1974.

HON. CLAIBORNE PELL,
Chairman, Senate Education Subcommittee

DEAR SENATOR PELL, The announcement of your Senate Education Subcommittee's hearings in September is of great interest to the financial aid community.

The initial hearings dealing with proprietary institutions will, I hope, deal with the State responsibility for adequate control of the management practices in regard to student financial aid at such schools. States which govern licensing of such schools should be required to conduct program reviews and training of personnel involved in the assignment and expenditure of student financial aid funds whether from state or federal sources. The condition of financial aid operations at such schools is frightening. Rather than jeopardize the entire program I feel that you should insist that each state be responsible for training and program review of those schools to which it issues licenses. States which do not possess such a capability should be required to provide it in order to retain eligibility for Federal student financial aid funds.

The second hearings on the GSL program should point up the necessity for a new approach to the student loan programs. With majority at age 18 a fact, it is ridiculous to attempt to continue operations in the same old-fashioned way i.e., dependent on parental income figures. Therefore, let me propose a radical new approach to student loans which are guaranteed and insured by the Federal government:

(1) Any eligible student may negotiate a student loan without parental signatures. Limits would be set at \$2,500 per year, maximum \$10,000 for undergraduate training.

(2) Students' social security number would be primary identification for transaction purposes.

(3) Loan funds would be provided either by Federal government or private sources.

(4) Repayments would be made directly to the Federal government via IRS system with students paying loans in the same manner they pay income tax due to the Federal government.

Student loans are an integral part of the financing structure of post-secondary education but the present cumbersome system must be streamlined or else the access to post-secondary education will be jeopardized.

I would be willing to participate in the hearings or to assist in any manner you wish.

Sincerely yours,

P. JEROME CUNNINGHAM,
Past President.

JACK V. HOSKINS,
ATTORNEY AND COUNSELOR AT LAW,
St. Louis, Mo., September 19, 1974.

Mrs. VIVIAN MOORE,
Administrative Assistant, Office of Senator Stuart Symington,
U. S. Senator for State of Missouri, Senate Office Building, Washington, D.C.

DEAR MRS. MOORE: You have been so helpful in the past, and to avoid writing directly to Senator Symington, I forward this letter to you with the hope that you will be able to take up the matter with the Senator, at his convenience, and explore the possibilities that I will outline in this letter.

Enclosed you will find an Article about college students and government loans. To give you a brief history, I feel that the U.S. government is very lax in collection of student loans. While attending Law School, I did borrow government funds and I was out of law school almost ten (10) years before a bank in Chicago called me on the telephone to tell me that I was in default. I quite frankly did not know where to send my payments nor did I even realize that a bank in Chicago was involved in the loan. I would have gladly paid my account in full within twelve (12) months after leaving law school.

I think that it is a wasteful shame to "write off" the money that these former students, now employed, would gladly pay if they were so notified, that they did in fact owe the money.

Therefore, I wish to propose the following and it would mean jobs for St. Louis residents and would allow the United States government to recover a great deal of sums of money. Here is my proposal:

1. An office could be set up in the St. Louis area solely to collect, notify, encourage, file lawsuits and act as a collection agency for the United States Government on these student loans.

2. As an attorney, I would be willing to head this organization and all moneys collected by this private Missouri corporation would be paid to me on a contingent attorney fee basis.

3. The United States Government could agree to pay the salaries to underprivileged and the less fortunate and give them jobs as file clerks, typists, etc.

4. This Missouri corporation would require that all records be kept in St. Louis, proper computers and IBM equipment installed, and that billings would go out on a regular basis to insure immediate collection.

5. Although students would be living in 50 different states, in the event that a lawsuit would have to be filed for collection, I would then procure the services of an attorney in each State for collection purposes.

I believe that this idea is sound. Its advantages would be in giving various people jobs, it would put money into the St. Louis County area, and most importantly, it would return money to the United States Government in our fight against inflation.

Mrs. Moore, I regret the length of this letter, but I hope that my business proposition is sound and I feel that it is, and I would be most appreciative if you would discuss the matter with Senator Symington and if necessary, I would come to Washington to discuss implementation of this program in Missouri.

Very truly yours,

JACK V. HOSKINS.

COLLEGE STUDENTS DEFAULT ON \$252 MILLION GOVERNMENT LOAN

Students who took out federally guaranteed loans to attend college have defaulted on their loans to the tune of \$245 million.

The government has also had to write off an additional \$7 million in loans made to students who filed for bankruptcy after they left school.

"This situation has reached crisis proportions," The ENQUIRER was told by U.S. Rep. Daniel J. Flood, (D., Mo.), who is chairman of the House appropriations subcommittee on Labor, Health, Education and Welfare.

The default rate on federal Guaranteed Student Loans is increasing at an alarming rate, confirmed James Moore, deputy commissioner of education in charge of the loans. "The annual default rate for fiscal 1973 was 5.2 percent," he said.

"We're afraid that's going up to 7.2 percent this year."

Moore said the Guaranteed Student Loan Program was enacted as part of the Higher Education Act of 1965.

It was intended to encourage private agencies to loan money to college students who needed money to complete their educations.

The federal government insures the loans.

Thus, lenders don't have to worry about losing their money. A student can borrow up to \$7,500. He can take from 5 to 10 years to repay the loan and his payments don't have to start until 12 months after he leaves school—three years if the student, after leaving school, went into the Armed Forces, the Peace Corps or VISTA, the "domestic peace corps."

Said Moore: "By the end of this fiscal year, the total amount of defaulted loans we'll have to pay off will be \$245 million."

"And we have also had to write off about \$7 million because of students filing bankruptcies after they get out of school."

BERNIE WARD.

November 18, 1974

Honorable Claiborne Pell, Chairman
Senate Subcommittee on Education
United States Senate
Washington, D. C.

Dear Senator Pell:

Recently I read an article entitled "Defaults Threaten Student Loans" which appeared in The Kansas City Star. Having worked a number of years in the area of college financial aids, and handling Guaranteed Student Loans, this article had a particular interest to me.

The article quotes Allan Purdy, member of the board of the Student Loan Marketing Association, saying that dropouts pose the biggest problem to the Guaranteed Loan Program.

I have known banks in several Kansas cities who were participating in the Guaranteed Student Loan Program and then discontinued making these types of loans to college and university students. I have talked with officials of these banks who stopped making these loans. A number of these bank officials indicated to me that one reason they discontinued these loans was due to delinquency of payments or defaults on the part of the student borrowers.

I feel that certain measures could be taken to help reduce or eliminate student delinquencies and defaults. I believe, under the present rules and regulations governing the Guaranteed Student Loan Program, a student has to indicate whether he is a full or part-time student in order to meet eligibility requirements. In addition to this requirement, I think it would be both beneficial to the lender and to the school if the student was required to submit to his lender proof that he was making adequate and satisfactory progress in school.

In the case of a student making application for an initial loan, he could be required to submit a copy of his grades and total number of hours passed for the previous semester. For an entering student to a college or university, he could be required to submit a copy of his high school transcript. After the first loan, a student could be required to submit a copy of his grades and hours passed for the previous semester, if he desired to make application for additional loans.

- 2 -

From my experience, I have found that under the present regulations of the Guaranteed Student Loan Program, some students receive these loans who are high risks. I have known some students who have received loans that completed a semester of school work and may have done poorly. I think if the lender was aware that a student did poorly, then he may wish to give this applicant more careful consideration before making a decision in granting the loan.

It is logical that a student may have a poor semester due to a number of reasons other than just not applying himself. These could include ill health, working too many hours, personal or family problems and interests not in this field and wish to change majors. I believe if the lender had this information about the student's progress, then he could discuss this problem with him. The lender could then determine if the student had legitimate cause for not making satisfactory progress or he could, in his best judgment, not grant the loan.

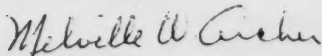
Whenever a student approached me about making an application for a Guaranteed Student Loan, I always checked his prior academic record. If he had done poorly the previous semester, or his entire record showed him not making satisfactory progress, I would discuss this with him and encourage him to try and do better in the future. Since the present regulations do not require academic records of students be submitted to lenders, I question that very few lenders are aware of the academic progress being made by the student.

Some bankers have told me that processing Guaranteed Student Loan applications is time consuming and a detailed process. If they would take a few more minutes and counsel with student applicants, if the need arises, then they would not only be helping their own cause, but be performing a great service to the student.

I know the Guaranteed Student Loan Program has made it possible for many deserving students to receive a college education. I believe there has been, and will continue to be, a definite need for these loans.

Enclosed is a copy of the article discussed above.

Sincerely yours,



Melville W. Archer
1117 Washington
Emporia, Kansas 66801

Enclosure (1)

[From the Kansas City Star]

DEFAULTS THREATEN STUDENT LOANS

(By Jim Swarts)

The burgeoning cost of higher education—already a burden to many U.S. families—may soon be a concern of all taxpayers as defaults in the guaranteed student loan program begin to take a bigger bite into federal revenues.

The loan repayment failures also are a growing worry to the American Bankers Association (A.B.A.), which recently asked Congress and the U.S. Office of Education to take immediate steps to remedy what it called an "intolerable" delinquency and loss record in the student financial aid sector.

The A.B.A. said the "continued viability of the program rests on the willingness of participating students to honor their borrowing commitments." The comment was made recently in a letter to Sen. Claiborne Pell (D-R.I.), chairman of the Senate subcommittee on education.

In its appeal to Congress and the education office group—citing the banking government statistics that indicate the highest delinquency rates occur where the school serves as the lender—said legislative curtailment of school-lending activities seems a must.

The A.B.A. also recommended that a distinction be made between students who default because of unemployment or other extenuating circumstances and those who are unwilling to meet their obligations.

"If a student is unwilling to repay, then all existing agencies of the federal government should be used to collect the defaulted loan," the letter stated. Special payment plans were suggested: One would require the student to pay only the interest on a loan during unemployment periods, and another would call for graduated payments for certain students in an effort to gear repayment to early post-graduation income.

So on the national level the student loan program would appear to be on shaky ground.

What about its status in this area? Are students here meeting their obligations? Or are delinquencies and defaults at that same "intolerable" level the A.B.A. is so concerned about?

OPTIMISTIC OUTLOOK

Ralph Gray, senior vice-president and manager of installment loans for United Missouri Bank here, has an optimistic outlook on the student loan program.

"Sure we've had some delinquencies, and we've had to file few claims with the federal government for reimbursement on defaulted loans, but our experience with the student borrowers over-all has been no different from our other personal loan dealings."

Gray said the bank was involved in the program "in the millions," and he had found the vast majority of students to be a very appreciative and co-operative group.

Gray said United recently cut a lending limit to \$1,500 a year for each student borrower—\$1,000 under the maximum allowable in the student loan program—"so we can help more students."

The program is not funded by the government and the bank determines the amount of money available for such loans, he explained.

"Whatever the amount we decide to lend to students, we'll be able to assist more of them in their pursuit of a higher education."

United Missouri intends to stay in the program, he added.

At the Goppert Bank & Trust Co., Steve Young, student loan officer, echoed United Missouri's view.

"We've had a good experience with borrowers under the guaranteed student loan program, and I think it's good business for us."

Misunderstanding

Young believes the problem on the national level might be traceable to a misunderstanding on the part of many students about their responsibility in such matters.

"Some of these young people have said they weren't told such details—they thought because the government had a part in it that it wasn't too important that the loans be repaid. We see to it that they have a much better understanding of the program when we talk to them," Young said. He added that his bank's delinquency rate has been "negligible."

A loan officer of a Johnson County bank said delinquencies had risen in the last two years—"but not at an alarming rate." Another suburban banking institution

indicated that it would be more restrictive in its future student loan activity because of some slow repayments.

One large Downtown Kansas City bank said it had withdrawn from the student loan program several years ago and didn't plan to get back into it. Another big banking institution said that, in effect, it had quit the program two years ago.

"We're still honoring the student loans we made three years ago, but when we've seen those students through school we'll drop out of the program," a bank official said.

"We're not turning our back on student needs, but we had trouble locating some of our student borrowers after graduation—they had left this area and found jobs elsewhere. And several had the idea they really weren't responsible for the repayment of the loans.

"They thought their parents were legally responsible because they had cosigned the notes." He added that such collection problems were even more difficult to live with "when you consider that we have to hold these loans up to four years without any payments on the principal.

"Under all those circumstances we decided the program just wasn't good business for us," he concluded.

Allan Purdy, director of student financial aid services at the University of Missouri-Columbia, a lender under the guaranteed loan program, was more philosophical.

Admitting that the 4-campus educational complex has some bad loans on its books—"the delinquencies are between 14 and 15 percent and the loss rate about 6 percent"—Purdy sees the problem as a sociological as well as a financial issue.

"It's also been accentuated by the fact that many of the university's loans have been made to students who were turned down by the bankers in their home towns.

"As a lender of last resort, we naturally have assumed some higher risk loans," Purdy said.

He then did some backtracking.

"Remember our nationwide war on poverty in the 1962's" he asked. "Those were the times when government and society in general were urging youths from low-income families to borrow to go to school. A higher education was a must, we told them.

"So, many of them did just that—with the result that a lot of those graduates of that era wound up with big debts to go with their sheepskins. And some of them couldn't meet their financial obligations.

"Then in June, 1972, the federal government comes up with a grant program—the Basic Educational Opportunity for that same low-income group. Half a billion dollars were earmarked for outright grants, or gifts, to students in that financial category," Purdy recalled.

"Those students of the 1960s didn't have that kind of help, so quite a few of them showed up on the delinquency and default lists.

"On the one hand you lend a billion dollars and fail to get 5 or 6 per cent of it back, and on the other hand you make an outright gift, or grant, of half a billion for the same purpose.

"It's a sociological program we're talking about," he insisted.

Purdy said he definitely is not in favor of students failing to repay their education loans, but he believes the sociological aspect of the problem needs some airing.

Purdy said that from 1958, when the National Defense Student Loan program went into effect, until 1971 the U.M.C. made student loans totaling about \$25 million but since the creation of the 4-campus complex 3½ years ago only \$750,000 in loans had been made to students at all locations.

Purdy does not see cause for alarm in the delinquencies and defaults that were responsible for A.B.A.'s recent outcry, "because I believe that in any program like this you will have some losses—and they're not all the result of an unwillingness on the part of former students to meet their obligations.

"Dropouts pose the biggest problem, of course, because those students probably will wind up with lower paying jobs than what they had planned for originally. And other economic factors can put the student borrower in a financial bind."

The U.M.C. official, who is a member of the board of the Washington-based Student Loan Marketing Association, still believes in the basic honesty of the majority of student borrowers.

"We're still getting payments from some of them months after we've written them off and received reimbursement from the government. We're sending money back to the insurer nearly every month," he concluded. "We're being a little more restrictive in our lending policy," he explained.

5220 Wilshire Boulevard
Los Angeles California 90036
213 937 2450

U-S LIFE SAVINGS and Loan Association

September 18, 1974

The Honorable Alan Cranston
United States Senator
1100 Wilshire Boulevard
Los Angeles, California 90024

Dear Alan:

At the risk of being premature, I am seeking your advice on a matter of serious concern to this Association and others in the industry.

Due to a close personal relationship between W. W. McAllister, president of San Antonio Savings and Loan Association, and our president, W. A. Girardin, we have been jointly pursuing a dispute we have involving the Federally Insured Student Loan program and the Office of Education.

As a brief review of the legislative rationale behind the program, I would use as a starting point the unequivocal language of Section 1075(b) of Title IV [20U.S.C.A. Section 1075(b)] which states in part:

"The insurance liability of any loan insured by the Commissioner under this part shall be 100 percent of the unpaid balance of the principal amount of the loan plus interest."

No where in the Law or Regulations is there any dilution of this clear legislative statement.

My research of the Congressional record indicates that the emphasis throughout the hearings was on the "no-risk" aspects of the program which would make it attractive to eligible lenders.

Trade schools as well as institutions of higher learning were accredited for the program.

Both schools and third-party financial institutions could qualify as "eligible lenders" if they were:

"Subject to examination and supervision by the government of the United States or by any state or pension plan approved by the Commissioner for this purpose."

A US LIFE COMPANY

Los Angeles (Main Office) Baldwin Park Hollywood La Habra North Hollywood
Redondo Beach Riverside San Fernando San Pedro Sun Valley Westchester West Covina



Page 2

The Honorable Alan Cranston

As a matter of practice many schools originated loans to entering students, then sold them by assignment to eligible financial institutions in order to continue the generation of new capital to meet their own expenses.

Before any student's loan application was finally accepted by a school-lender, the Office of Education in the Department of Health, Education and Welfare would first have to indicate that the loan was, in fact, insured under the program. Note, that all applications and promissory notes were on forms designed and required by the Office of Education.

The contractual obligation of repayment of a student loan runs from the student to the holder of the note and, in the event of default after exercising due diligence in the collection process, the holder of the note assigns it to the Office of Education with its claim for the insurance.

This program of schools originating loans and selling the insured paper to eligible third-party lenders seemed to be working well until about a year ago, when it was suggested surreptitiously by a regional office of the Office of Education that the promissory note they had designed was not a negotiable instrument; therefore, any subsequent holder of the note took it subject to all personal defenses which a borrower or student would have against the school.

It developed that many educational institutions, almost all of them trade schools, owed refunds to their students for a variety of reasons, e.g., failure to matriculate, early drop out, etc.

In a situation where the school has originated the loan, sold it to the financial institution and gone bankrupt or misapplied a refund due to a student, the Office of Education has now taken the position that, due to the non-negotiability of the instrument, that portion of the loan represented by a refund due the student is not insured. Note that if the financial institution had originated the loan directly to the student rather than purchasing the paper from the school, the Office of Education would pay 100% of the claim when a refund was owing.

Please forgive this rather lengthy prelude, but I wanted you to have sufficient background material to understand our position.

BEST COPY AVAILABLE

Page 3
The Honorable Alan Cranston

Although I am unable to get an official reason from the Office of Education for designing a non-negotiable note, my reading of the legislative history of the Act leads me to believe that it was to keep the notes out of the hands of ineligible lenders. All assignments of notes were subject to notification of and approval by the Office of Education. If they did not exercise control over the negotiability of the note, it could easily end up in the hands of a "holder in due course" who could harass students without any obligation to follow the rules of due diligence and collection following the statutory grace periods.

Mr. McAllister spoke with Senator Tower prior to instructing his attorney, Thomas H. Peterson, to direct an appeal to James W. Moore, Acting Assistant Commissioner of the Guaranteed Student Loan Program.

We were led to believe that there would be some exhaustion of administrative remedies prior to our contacting your office, but as you can see from the enclosed letter, Senator Tower has already forcefully entered the picture. Also enclosed is a copy of Mr. Peterson's letter of appeal to Mr. Moore.

I am now soliciting your advice as to whether we should request any action from your office now or wait for a reply from Mr. Moore to Senator Tower or Mr. Peterson.

In any event, we wanted to keep you posted as to the existence of this problem and our position in the entire matter which could well involve losses of millions of dollars to California financial institutions which innocently relied upon the written and oral representations of the Office of Education regarding 100% insurance of Federally Insured Student Loans.

Cordially,



Kenneth C. Adams
Vice President & General Counsel

KCA/pj
Enclosures

cc: W. A. Giraldin
Thomas H. Peterson, Esq.

United States Senate

WASHINGTON, D. C. 20510

ARMED SERVICES
BANKING, HOUSING AND
URBAN AFFAIRS
JOINT COMMITTEE ON
DEFENSE PRODUCTION

August 29, 1974

Mr. James W. Moore
Acting Associate Commissioner
Guaranteed Student Loans
Department of Health, Education and Welfare
Washington, D. C.

Dear Mr. Moore:

I have been in contact with Mr. Walter W. McAllister, III, regarding a dispute between the San Antonio Savings Association and the Department of Health, Education and Welfare. Mr. McAllister is Executive Vice President of the Association. The controversy is detailed in a copy of the letter of August 22, 1974, to you from Mr. Peterson of the Sawtelle, Goode law firm in San Antonio, and I have the following observations to make in connection with the matter.

There are several basic policies underlying programs of federal insurance for education loans. One is congressional recognition of the value of education and a concomitant interest in fostering it. Another is the specific value of vocational education in an increasingly technocratic society. Additionally, Congress is not blind to lenders' perceptions of risk in connection with education loans, especially in cases where the educational institution does not have a background of financial stability or an identifiable educational tradition.

After having read Mr. Peterson's letter, which I assume accurately reflects the content of the Jenkins memorandum, I opine that HEW's denial of the Association's claims on the basis of the technical nature of the instrument prescribed by HEW would not only clearly frustrate the intentions of Congress, but would, in fact, be unconscionable. I am certain, however, that the Department would want to avoid such results. I strongly recommend that HEW repudiate the position taken in the Jenkins memorandum and dispose of the Association appeal accordingly. I also request that this letter be made a part of the file.

Sincerely yours,

John Tower
John Tower

cc: Honorable Caspar Weinberger

bxc: Mr. W. W. McAllister, III ✓

SAWTELLE, GOODE, DAVIDSON & TROILO

ROBERT SAWTELLE
JOHN GOODE
JOHN H. DAVIDSON
ARTHUR TROILO, JR.
THOMAS H. PETERSON
TERRY TROILAN
DOYLE L. EDGARNEY
MARQUIS E. WHITTINGTON
RICHARD H. WOLF
JAMES H. HOLBROOK
JOSEPH E. ELLIOTT

ATTORNEYS AT LAW
1000 SAN ANTONIO SAVINGS BUILDING
111 SOLEDAD STREET
SAN ANTONIO, TEXAS 78205

(512) 222-0301

August 22, 1974

Mr. James W. Moore,
Acting Associate Commissioner
Office of Guaranteed Student Loans
Office of Education
Department of Health, Education
and Welfare
Washington, D. C. 20202

Re: Federally Insured Student Loan Claim
No. 424-36692 - Sammy Pose (SASA Account
No. 701-1812-1) et al.

Dear Mr. Moore:

We have been advised by the office of Mr. John M. Stokes, Regional Attorney for the Department of Health, Education and Welfare in Dallas, Texas, that you are the proper party to whom we should turn for our administrative appeal of the action of Mr. Michael A. McRighe, Chief of the Claims Section, Claims and Collection Branch of the Office of Guaranteed Student Loans, Office of Education, and others in the Department who have refused all or a portion of the claims set out in the attachments to this letter. We have been informed that the refusal of these claims is based upon a memorandum dated July 18, 1973 from Mr. Harold B. Jenkins, attorney in the Education Division, to Mr. William Simmons.

As we understand it, the position taken by those who have denied our client's claims has been one based upon this memorandum from Mr. Jenkins to Mr. Simmons. The position is that San Antonio Savings Association cannot be a holder in due course because the notes involved are not negotiable notes. Accordingly, the position is taken that because of the failure of the schools from whom the Association purchased the notes to make refunds to the students involved, the Association cannot legally recover the balance due from the students against which your Department feels the students have an off-set right for refunds.

Our position in this matter is very simple. The law provides that the United States Department of Health, Education and Welfare guarantees 100% of the balance due upon any Federally insured

Mr. James W. Moore, 2.
Acting Associate Commissioner

August 22, 1974

student loan. Our client, San Antonio Savings Association, purchased these notes prepared upon forms which were prescribed by your Department, from schools which had been Federally authorized to participate in this program. Our client, San Antonio Savings Association, is a duly authorized lending institution operating within the Federally insured student loan program. The provisions of Section 1075(b) of Title IV [20 U.S.C.A. §1075(b)], states in part:

"... the insurance liability of any loan insured by the commissioner under this part shall be 100% of the unpaid balance of the principal amount of the loan plus interest." (Emphasis added by the writer of this letter)

Additionally, our client has complied with all of the provisions of 45 C.F.R., Sections 177.48 and 177.49. It is our opinion that San Antonio Savings Association is therefore entitled to full payment upon these claims based upon these Sections, particularly the provisions of Section 177.49(d). Section 177.49(d) provides:

"the insurance coverage on notes transferred or assigned in accordance with the provisions of this section shall remain in full force and effect and any matters required of lenders in order to perfect a claim on such notes under this part may be performed by the transferee or assignee."

The position now being taken by the Department of Health, Education and Welfare in connection with the claims set out in the attachments to this letter is inconsistent with past payments on similar claims and past communications from the Department of Health, Education and Welfare. Specifically we have found form letters from the Dallas Regional Office signed by Leo A. Hatten, which advised the student in each case as follows:

- "1. If we insure your application, you must repay this loan with interest, whether or not you complete your course of study."
- "4. The Office of Education does not accredit schools nor do we guaranty a school's performance. Schools eligible for the program have been accredited by a private agency chosen to perform this task. This private agency sets the minimum refund policy of its

Mr. James W. Moore, 3.
Acting Associate Commissioner

August 22, 1974

member schools, but does not guarantee that you will get a refund if you drop out of school, or if the school should close. Neither can the Federal government guarantee you a proper refund.

- "5. There is no Federal money in this loan. The Office of Education makes no loans under the Federally insured student loan program. Your debt will be to a private lending institution and the Office of Education will have no authority to cancel or control your indebtedness under the Federally insured student loan program. If you borrow under the program, you will have to repay this money.

- "6. If the school should close before you complete your course, you must still repay your debt to the lender.
***** (Emphasis supplied by the writer of this letter) ..

In view of the above authorities, it is our position that there is nothing in the law or the regulations making the San Antonio Savings Association, the insurer of these loans. It was the intention of Congress, in our opinion, to make the government the insurer on these accounts. As we understood the operation of this program, up until the issuance of the memorandum to Mr. Simmons, the government paid 100% of the loan balance in each case. In all these claims except the Carol Digges case the Department of Health, Education and Welfare has recognized the due diligence of our client's attempts to collect the balances due by tendering partial payment of the claims. It appears that only the refund problem prevented full payments.

In that one case which arose after the compilation of the attached list, and designated Insurance Claim No. 42402461, by the Department of Health, Education and Welfare upon Carol Digges, Social Security No. 451-08-2256, our client was denied an entire claim, in the amount claimed of \$1,195.00 on the basis of the allegation that the borrower never attended classes. The file in the Digges case shows that the student was sent a notice that the Association had purchased the account promptly after the Association's purchase of the account and was sent a card and a self-addressed envelope to advise the Association in the event of any change in the status regarding the Federally insured student loan. The Association never received any communication from Carol Digges. The Association did not learn of any problems between Carol Digges and the

Mr. James W. Moore, .
Acting Associate Commissioner

4.

August 22, 1974

school until several months later. The school involved, as in all the other claims involved in this appeal, is completely unable to pay the Association upon the account after the Association has made diligent efforts to collect from each school. Your Department has in its possession all of the claims involved except the claim for Carol Digges and the supporting documents which shall be attached with this letter. It is our understanding that a notification to each student of the negotiation of his or her note was used in the case of each of the other claims involved in this appeal and that in each case the Association exerted due diligence to collect from the student prior to making application in accordance with the provisions of your regulations.

One other case has been received subsequent to the compilation of the original list of claims enclosed in the attachments. In this case, the claim concerns the account of Linda Beasley, No. 701-1963-7. This claim was made in the sum of \$1,200.00 and a claim check was received in the amount of \$316.45 by our client.

On our enclosed summary as to the other claims, the information will show the name of the student, the account number with the Association, the claim number assigned by your department, the amount for which claim was made, the amount actually received and the number of the Treasury Check upon which the disbursement was made. We have advised our client not to accept the partial payments and will return these checks upon receipt of checks representing the full amount claimed.

As we have stated previously in a letter to Mr. John M. Stokes, it seems inappropriate and unfair for the government to prescribe the form for the notes in this program, set up a system for approving educational institutions, provide for assignments of the notes to lending institutions, issue regulations based upon a statute passed by Congress, none of which make any reference to any obligation of the government except to pay 100% of the indebtedness upon the failure of the student to pay, and then to use a commercial technicality in the note drafted and prescribed by the government to deny the claims.

Furthermore, as we stated previously to Mr. Stokes, we did not have to go out of the City limits of San Antonio, Texas to find another lender whose claims in the same types of fact situations are being paid, according to its representatives. We have not revealed to you the name of the other lender since if we should

Mr. James W. Moore, S.
Acting Associate Commissioner

August 22, 1974

and the claims of that lender should then be denied, that lender would feel that we had breached the confidence and would no longer share confidences with us in the future.

If the Department of Health, Education and Welfare persists with this interpretation of the law, it is our opinion that the Federally insured student loan program will lose the vitally needed support of the commercial sector of our economy and jeopardize the entire concept. Accordingly, we respectfully urge the immediate reconsideration of these claims.

Sincerely,

Thomas H. Peterson

THP:ml
Enclosures

cc: Mr. W. W. McAllister, III

Mr. Lewis Barnes

Mr. Michael McTighe

Mr. Leo A. Hatten

Mr. John M. Stokes

#7804-74

BEST COPY AVAILABLE

160



State of New Jersey
DEPARTMENT OF HIGHER EDUCATION
OFFICE OF STUDENT ASSISTANCE
1474 PROSPECT STREET
P. O. BOX 1417
TRENTON, NEW JERSEY 08625

December 12, 1974

Mr. Stephen Wexler, Counsel
Dickinson Office Building
Room #4228
Washington, D. C. 20510

Dear Steve:

Because of your interest and concern about the Guaranteed Student Loan Program, I thought you might be interested in seeing the enclosed letter and information sent to members of the New Jersey Congressional delegation. We read many stories about the problem of defaults in the student loan program and I just wanted to set the record straight as far as New Jersey is concerned.

If you have any questions or want clarification of any aspect of the report, please do not hesitate to call me at area code 609 - 292-3906.

Sincerely yours,

Bill

William C. Nester, Director
New Jersey Higher Education
Assistance Authority

WCN:mb
Enclosures

165

BEST COPY AVAILABLE



State of New Jersey

DEPARTMENT OF HIGHER EDUCATION

OFFICE OF STUDENT ASSISTANCE

1474 PROSPECT STREET

P. O. BOX 1417

TRENTON, NEW JERSEY 08625

M E M O R A N D U M

October 15, 1974

TO: The Chief Executive Officer

FROM: William C. Nester, Director
New Jersey Higher Education Assistance Authority

Let me begin by commending those of you who, through the Guaranteed Student Loan Program, have granted over \$300 million to 140,000 New Jersey residents since 1960 to help them continue their education beyond high school. The loan volume this year has been good in spite of the very tight money conditions. Your efforts and continued support of this very worthy public endeavor is appreciated.

From time to time some of you have expressed concern about the default rate in the Student Loan Program. Recent articles in the news media have underscored that concern even though many of the articles tell only part of the story. In an effort to clarify the default picture, I have analyzed the situation in New Jersey and report to you via the attached graphs.

Most of our students are fulfilling their responsibility and are now repaying the lender from whom they borrowed. We can say with pride that 95.2% of the students with matured loans are meeting their commitments as scheduled, and of the 4.8% who are not, 3.8% are negotiating with or making payment to the New Jersey Higher Education Assistance Authority, including more than 400 who have repaid their "defaulted loan" in full. Our real problem, and loss, is with less than 1% of the students.

As you know, in any loan program there will be a loss and our responsibility is to keep that loss to a minimum. Let me assure you that we are making every effort to keep tight reins on the problem. We can use your continued help, however, and I would request that you ask your people responsible for Guaranteed Student Loans to review their procedures carefully, especially as they pertain to repayment. What attention is given to a delinquent loan? Do your people seek help from this office before it is too late to salvage a default? Cooperation has been very good, as the record attests, but I hope it will be even better in the future.

If you have a suggestion for improving our services or want clarification concerning any aspect of the Program, please feel free to telephone me at 609 - 292-3906.

WCN:mbs
Attachments

NEW JERSEY HIGHER EDUCATION ASSISTANCE AUTHORITY

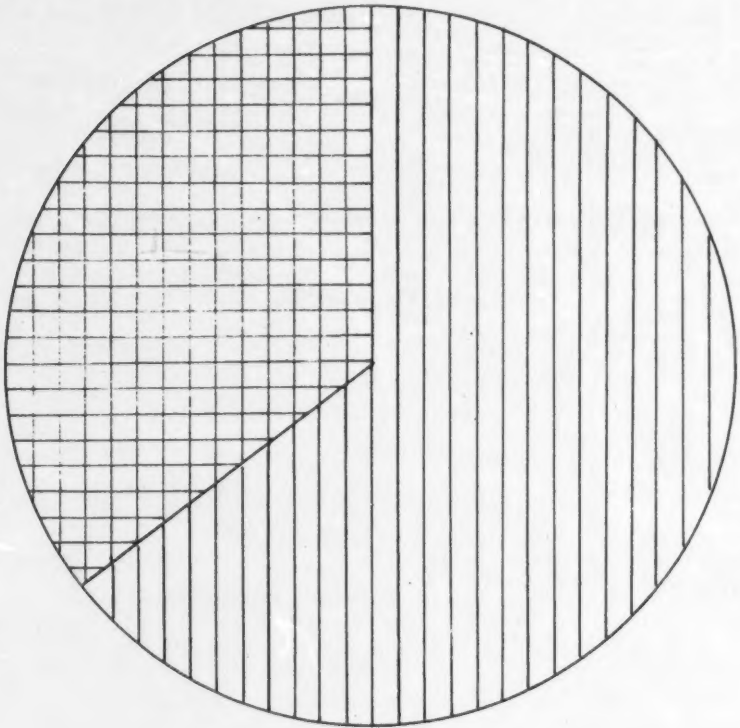
An Analysis of Defaulted Accounts

TABLE OF EXHIBITS

Exhibit 1	Total Loans Outstanding as of June 1974
Exhibit 2	Delinquency Letters Sent on Lenders' Behalf
Exhibit 3	Comparison of Preclaim-Saves to Defaults
Exhibit 4	Matured Paper as of June 1974
Exhibit 5	Classification of Loans Purchased by NJHEAA as of June 1974
Exhibit 6	Proportion of Collections to Claims Paid as of June 1974
Exhibit 7	Collections on Defaulted Accounts

William C. Nester, Director, NJHEAA
John P. DeFeo, Supervisor, NJHEAA

October 15, 1974

TOTAL LOANS OUTSTANDING AS OF JUNE 1974

Matured Paper

64.8%

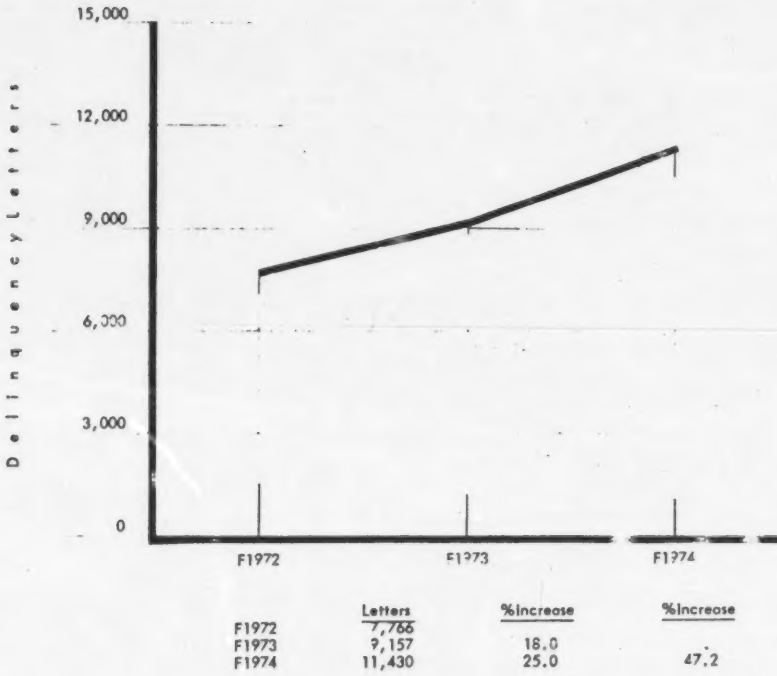
\$ 164,859,825



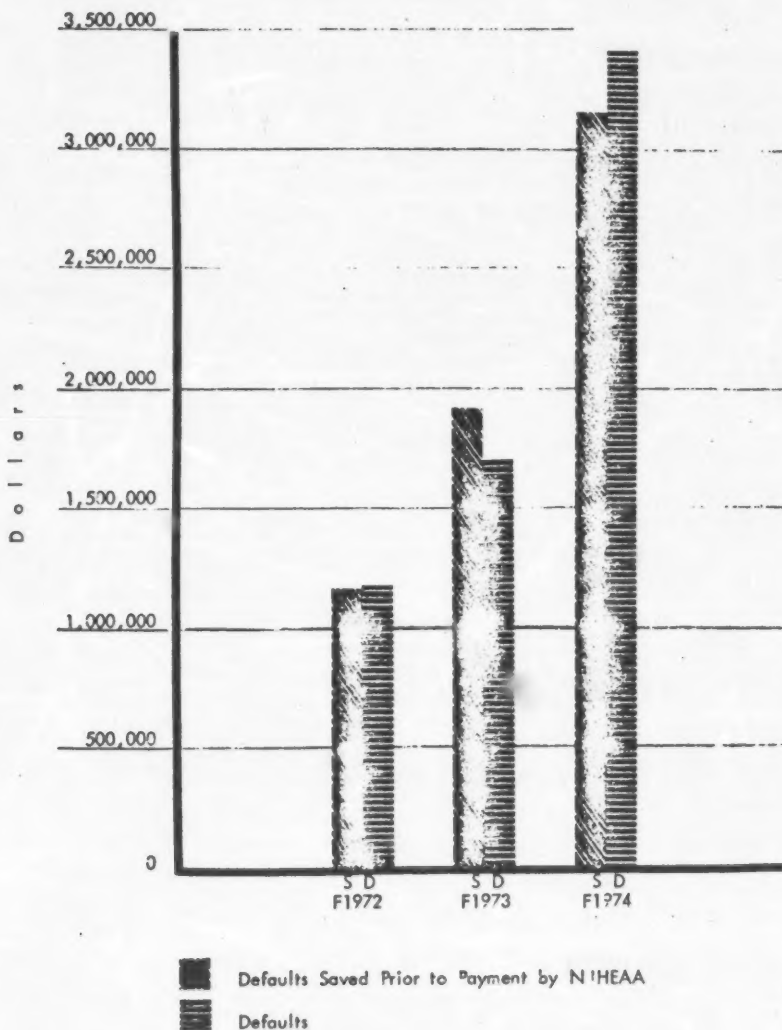
In School and Grace Period

35.2

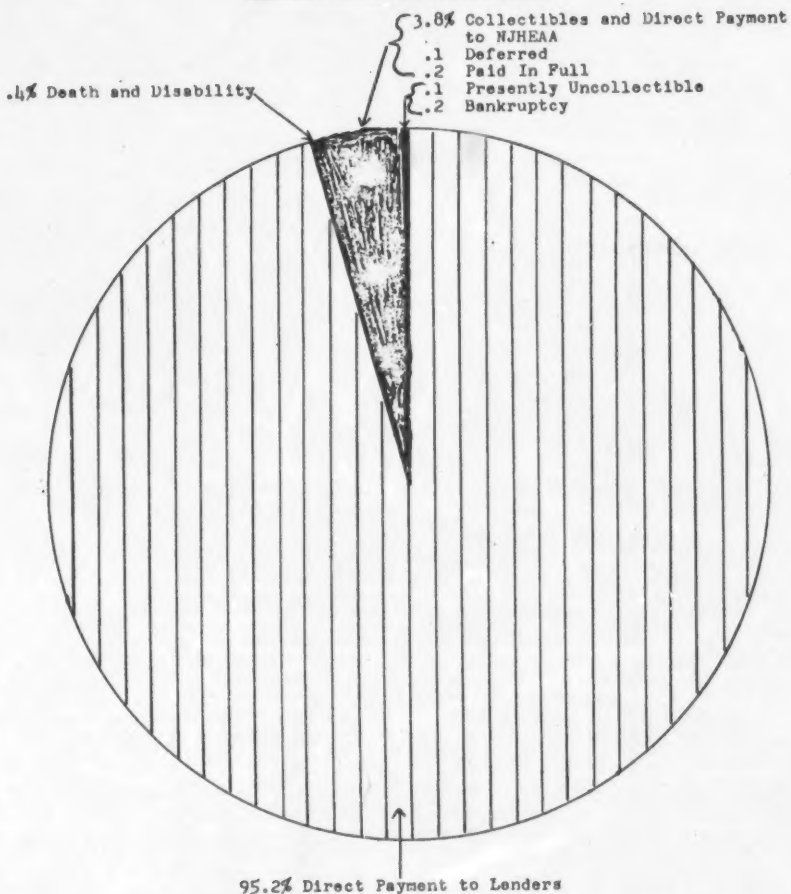
$$\frac{\$9,401,724}{254,261,549}$$

DELINQUENCY LETTERS SENT ON LENDERS' BEHALF

COMPARISON OF PRECLAIM-SAVES TO DEFAULTS

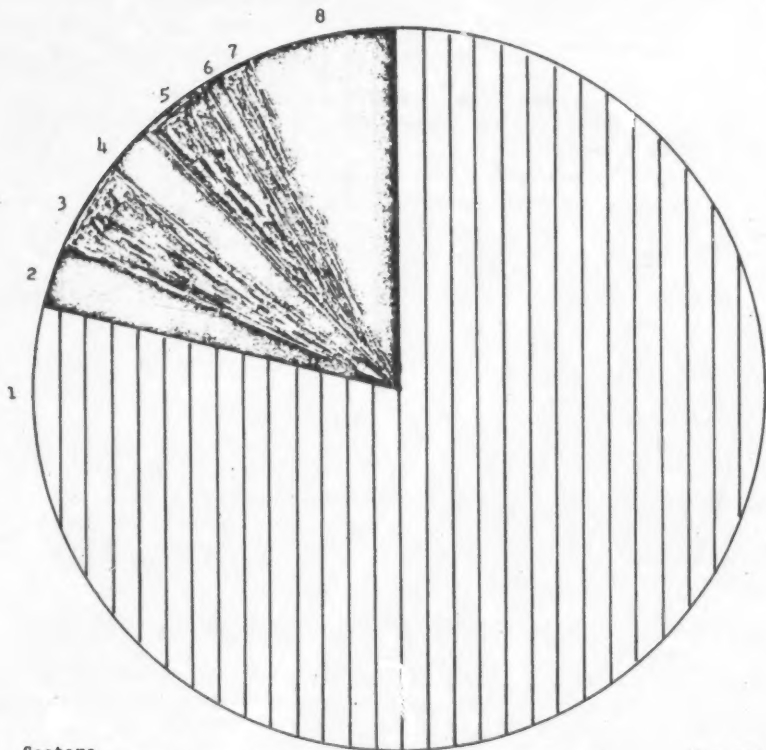


MATURED PAPER AS OF JUNE 1974



#3A

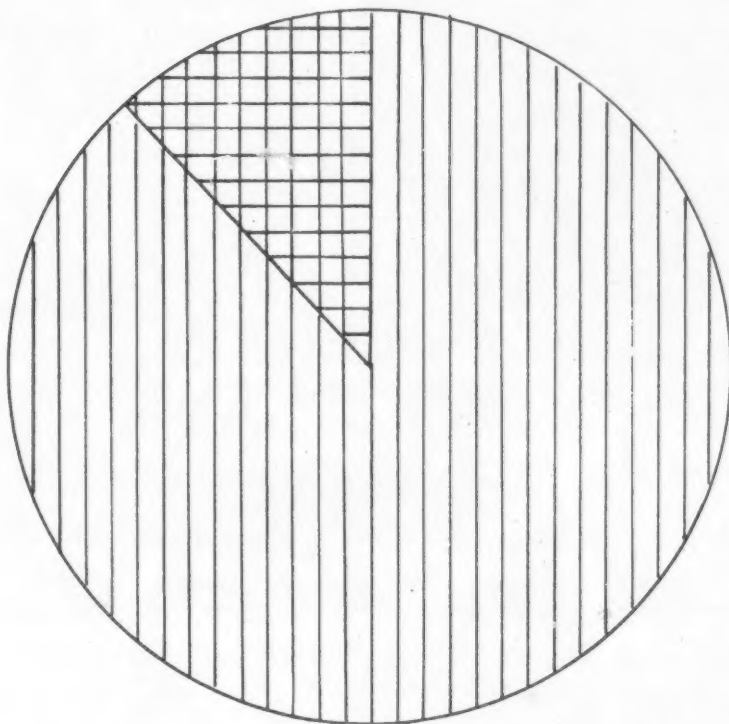
Exhibit 5

CLASSIFICATION OF LOANS PURCHASED BY NJHEAA AS OF JUNE 1974

Sectors			
1.	78.9%	Collectibles and Direct Payment to NJHEAA	\$ 6,323,363
2.	2.8	Deferred	223,173
3.	4.3	Paid In Full	343,672
4.	2.0	Collection Efforts Presently Exhausted	160,550
5.	3.5	Bankruptcy	280,105
6.	1.2	Chapter XIII Bankruptcy	16,750
7.	1.5	Disability	125,294
8.	0.8	Death	542,854

#5

Exhibit 6

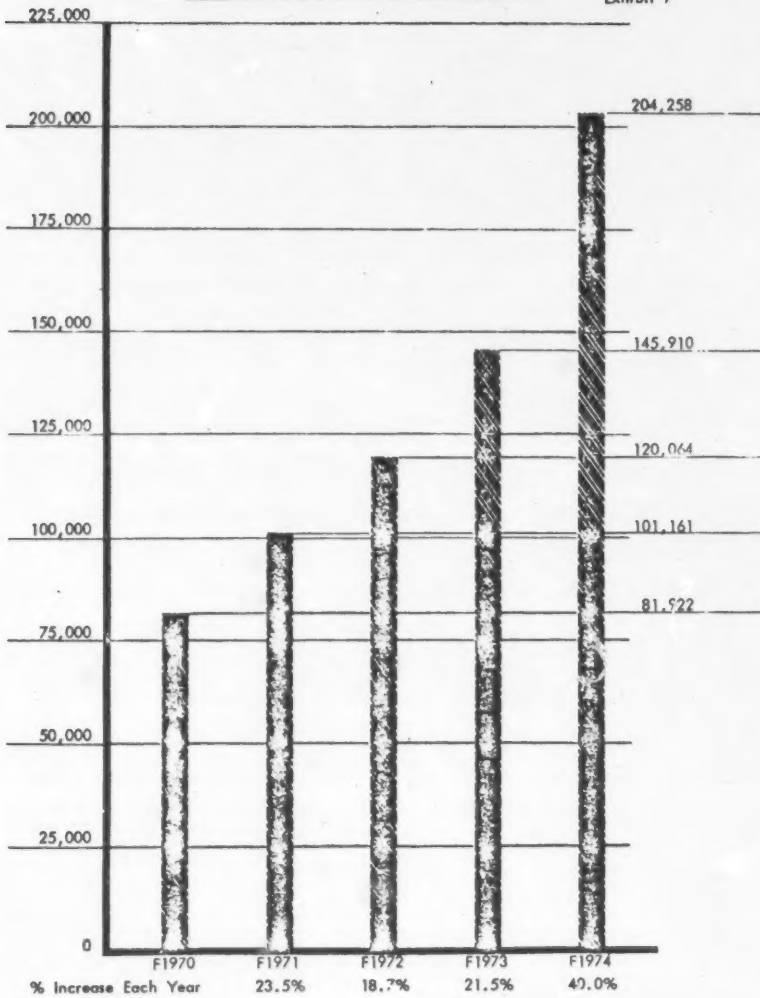
*PROPORTION OF COLLECTIONS TO CLAIMS PAID AS OF JUNE 1974

☐	Collections	12%	\$ 817,833
☒	Claims Paid	88%	6,872,175

*Minus Death, Disability, and Bankruptcy

COLLECTIONS ON DEFAULTED ACCOUNTS

Exhibit 7



571

174

Senator PELL. We will recess, the hearings to be continued at the call of the Chair.

[Whereupon, at 11:20 a.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]

○